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No.

In the Supreme Court of the United States

S.P. DAVIS, SR., WILLIE J. SINGLETON, PHILLIP PENNYWELL, JR., JAMES C. WILLIAMS, AND SAMUEL W. STEVENS III,

Petitioners,

v.

UNITED STATES OF AMERICA,

Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Section 6672(a) of the Internal Revenue Code, 26 U.S.C. §6672(a), provides that a "responsible person" who willfully fails to collect and pay certain employment taxes is liable to the government for a penalty in the amount of the tax that was not collected and paid. The question presented is whether the doctrine of equitable estoppel precludes a finding of willfulness in a Section 6672(a) action where the "responsible person" detrimentally relied on affirmative representations made by an IRS agent.

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit affirming the District Court's granting of summary judgment in favor of the United States is not reported, but is reprinted in Appendix A at pages 1a-15a.

The Memorandum Ruling and Judgment of the United States District Court, Western District of Louisiana, Shreveport Division, granting the Motion for Summary Judgment filed by the United States, dismissing the complaint of S.P. Davis, Sr. and finding each Petitioner indebted to the United States are not reported, but are reprinted in Appendix B at pages 16a-41a and Appendix C at pages 42a-44a, respectively.

The Memorandum Order of the United States District Court, Western District of Louisiana, Shreveport Division, denying Petitioners' Motion for Reconsideration and New Trial is not reported, but is reprinted in Appendix D at pages45a-49a.

JURISDICTION

On November 22, 2010, the United States Court of Appeals for the Fifth Circuit affirmed the District Court's granting of summary judgment in favor of the United States of America and against Petitioners. The court thereafter denied Petitioners' Petition for Rehearing on January 27, 2011. *See* Appendix E at pages 50a-51a.

Petitioners invoke the jurisdiction of this Court pursuant to 28 U.S.C. §1254(1) to review the decision of the United States Court of Appeals for the Fifth Circuit.

STATUTORY PROVISION INVOLVED

The Internal Revenue Code provides in pertinent part:

> Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.

26 U.S.C. §6672(a) (2011).

STATEMENT OF THE CASE

This case involves the aftermath of a failed multi-facility hospital network that served the poor and underprivileged citizens of Louisiana, the Winward Hospital system, which was funded primarily by Medicare. Petitioners were officers and directors who were each summarily cast in judgment for "willfully" failing to pay more than $3 million in allegedly due and unpaid payroll taxes. The finding of willfulness is based on the fact that Petitioners continued to pay non-IRS creditors, in addition to

the IRS, while a negotiated installment agreement with the IRS, which contemplated continuation of business operations, was being perfected.

Petitioners respectfully submit that the IRS should not be allowed to penalize them based on actions taken in express reliance on the representations of the IRS agent in the field and without which Petitioners would not have continued operations. This is particularly true when the IRS promoted the continuation of the business operations as a means by which the IRS expected the business to fund the payment of the delinquent taxes. It is also a manifest injustice to the Petitioners who could have avoided personal liability by simply closing the doors and walking away in November of 1997 when the delinquency was discovered. Rather, after acting in detrimental reliance on the representations of the IRS, the IRS invokes the presumption of "willfulness" merely because the Petitioners did what had been discussed with, and agreed by, the IRS as part of the overall plan to resolve the tax delinquencies and based on the conduct of the Petitioners during the time that the agreement was being finalized. Petitioners submit that the IRS should be estopped from basing any presumption of willfulness on the conduct of Petitioners during the time that the proposed agreement was being negotiated and during which the operations of the hospital were continued with the express consent and approval of the IRS.

A. Factual Background

1. Financial Hardship, First Knowledge of the Tax Deficiency and Attempts to Rectify

S.P. Davis, Sr. ("Davis"), Willie J. Singleton ("Singleton"), Phillip Pennywell, Jr. ("Pennywell") and James C. Williams ("Williams")[1] were equal owners, officers, and members of the board of Winward Institute, doing business as Winward Hospital, Winward Health Care Center, Inc. and Mynex, Inc. (hereafter referred to as the "Mynex-Winward entities"). The hospital and the clinic provided medical services to Louisiana patients and Mynex provided the hospital and clinic with management, transportation, therapy, and marketing services, as well as pharmaceutical services and products. Mynex's management division provided the officers, vice presidents, and all accounting functions – including, but not limited to, payroll, billing and accounts receivable, accounts payable, and reporting – for the Winward companies.

Serving the poor and underprivileged citizens of Louisiana, the hospital generated most of its income through Medicare and Medicaid payments. In 1997, after Medicare reduced its reimbursement rates and determined that the hospital had been overpaid $6 million by Medicare, the hospital experienced significant financial problems. These problems led it to cut staff and implement a number of other cost-cutting measures. The hospital also entered into a financing agreement with Daiwa, a financial services

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[1] Davis, Singleton, Pennywell and Williams are sometimes collectively referred to as the "Davis Group."

company, under which Daiwa provided periodic loans to the hospital equal to a portion of the hospital's accounts receivable. From that time in 1997, Daiwa was withholding funds from the Mynex-Winward entities until Medicare settled the amount due by an audit that was expected to be completed by December 1, 1997. It is undisputed that by the time that the installment agreement was proposed in November of 1997, the Mynex-Winward entities had incurred an operating loss of $2.7 million. R. pp. 2144-46.[2]

From January of 1997 onward, Samuel W. Stevens, III ("Stevens") served as the Vice President of Finance for Mynex. Shortly after his hiring, Stevens learned that the companies were delinquent in the payment of their federal trust fund taxes. As part of the Daiwa financing arrangement, Stevens was assured that the past taxes then were paid. See Exhibit 502, Exhibit 501, pp. 48-52, 54-55. When Stevens found out about the delinquencies in the fall of 1997, he immediately reported this to his supervisor, Dan Reid. Exhibit 501, pp. 80-82. However, the Davis Group did not learn of the payroll tax problems until November of 1997. R. pp. 1747-52, 1761-65, 1776-81, 1791-96, 1964.

The board immediately called an emergency board meeting and, upon being advised for the first time of the outstanding deficiency, the board specifically and affirmatively instructed Stevens and

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[2] The record cites are to the Court of Appeals for the Fifth Circuit's record.

Reid[3] to undertake a course of action to ensure the timely payment of all employee tax obligations. Stevens was instructed to make sure that no further employee tax obligations went unpaid. Stevens was further instructed to contact the IRS immediately and to attempt to work out an installment payment plan with the IRS to liquidate the accrued liability and to obtain a cancellation of the liens. On November 12, 1997, as instructed, Stevens contacted Carrie Carbo at the IRS and proposed an installment agreement for the entities which included allowing the entities to operate while the delinquency was cured. The evidence shows that the IRS allowed the entities to continue to operate pursuant to the proposed agreement first for 90 days and then thereafter.

Stevens communicated with the IRS and later reported to the board that the IRS had agreed to enter into an installment agreement which allowed the entities to continue to operate and that current payroll taxes were being properly paid. Petitioners specifically required that the amounts due to the IRS under the proposed agreement be paid in preference to the other creditors of Mynex-Winward. Meanwhile, Davis negotiated with several creditors to obtain payout terms to enable the entities to liquidate the accrued tax debts. Stevens reported to the board regularly at its weekly meetings on the

[3] Dan Reid was Stevens' supervisor until he resigned after the board learned of the IRS delinquent tax claim in November 1997.

status of the tax payments and on the payout plan from the IRS.[4]

From and after the initial disclosure of the problem and the emergency board action, the board members personally borrowed money, or otherwise made capital contributions to the Mynex-Winward entities, and voluntarily took compensation reductions to zero compensation to ensure the payment of the tax debts. Further, during the period of time between November of 1997 and March of 1998, the board was involved in a corporate restructuring program in order to cut costs of operations and to improve cash flow, especially while the Mynex-Winward entities attempted to negotiate with the Medicare program for relief from a decision that the entities had to repay approximately $6 million in unaudited and disputed Medicare payments from prior periods, while simultaneously reducing the current reimbursement amount to the entities.

Three months after the Davis Group learned of the tax deficiencies, on March 25, 1998, Winward Institute, Inc. d/b/a Winward Hospital was placed in an involuntary Chapter 7 bankruptcy. When Winward Institute, Inc., the moneymaking arm of the three entities, was forced into involuntary bankruptcy, the other two entities, Mynex, Inc. and Winward Healthcare Center, Inc., all but ceased to

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[4] While records of those board meetings existed at one time, the Bankruptcy Trustee had them and the other corporate records destroyed.

function.[5] More importantly, Daiwa was in control of the receipt of the Medicare and Medicaid funds and responsible for disbursing funds to the entities. The evidence presented by Petitioners, and corroborated by the IRS case record, is that the $6 million Medicare reimbursement claim had caused Daiwa to withhold funding and had caused the entities to suffer a $2.7 million operating loss through the third quarter of 1997. As evidenced by the docket sheet in the bankruptcy proceeding, Daiwa was called upon to provide an infusion of funds of up to $3.0 million to cover operating expenses and costs. R. pp. 1530, 1555, 1569, 1594-1617. With the advent of the bankruptcy proceeding, all funding from Daiwa was dramatically reduced to the point that, by May 5, 1998, the hospitals closed and their employees terminated. *Id.*

2. The Negotiated Installment Agreement

The uncontested facts demonstrate a meeting of the minds between Petitioners and the IRS concerning a proposed installment agreement that expressly contemplated the continuation of the Petitioners' business operations.

In late 1997, the IRS and the Mynex-Winward entities reached an agreement to enter into an

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[5] An involuntary Chapter 7 bankruptcy was later instituted against Mynex on October 2, 1998. However, the board continued to operate under the agreement with the IRS as it applied to Mynex, Inc. and Winward Healthcare Center, Inc., until the filing of the Mynex bankruptcy.

installment agreement which allowed the taxpayers to continue to operate and generate funds from which to pay the current and delinquent tax liabilities and, in furtherance thereof, to pay other creditors. R. pp. 1473, 1505, 1506, 1577-80, 1933-36, 1939-40, 1965, 2134-35, 2137. Petitioners provided sworn testimony that, as part of the agreement reached with the IRS, the Mynex-Winward entities were required to make timely all payroll tax deposits going forward. R. pp. 1933-36, 1939-40, 1964-65, 2134-35, 2137. An express condition of the agreement was to allow the companies to operate while paying on the past due taxes. The Davis Group further presented evidence that the payroll tax deposits were made through the payroll deposit system. R. pp. 1751, 1765-66, 1781, 1796, 1964. Indeed, the IRS record of April 20, 1998, confirms that current payroll deposits had been made by the taxpayers.[6]

While the IRS, solely through the affidavit of agent Carrie Carbo, denied that an installment agreement was *formally* effected, the IRS did not deny that the parties' negotiations resulted in an agreement to enter into an installment agreement. R. pp. 2188-90. In fact, the January 13, 1998 IRS case history notes unequivocally acknowledge the agreement to enter into an installment agreement:

> TC TO STEVENS. THEY PROPOSE TO PAY 25,000 PER MONTH, UNTIL MEDICARE AUDIT ISSUES ARE

[6] The Fifth Circuit ignored the IRS contemporaneous record of April 20, 1998, that the taxpayers were making current payments and that the IRS was proceeding with the installment agreement.

> RESOLVED. WE WILL SET UP IA [installment agreement] FOR 90 DAYS. AT THAT TIME, WE WILL REVIEW SITUATION, SEE IF THEY CAN PULL PAY OR INCREASE AMOUNT OF IA.

R. pp. 2134 (emphasis added). Furthermore, near the end of the 90-day initial term, on March 10, 1998, the IRS record not only acknowledges the agreement to enter into an installment agreement, but indicates that it would extend the agreement for an additional year:

> ... IT APPEARS THAT THIS IA IS THE ONLY WAY TO LIQUIDATE LIABILITY. I AM GOING TO RECOMMEND WE DO IA FOR 1 YEAR, WITH FOLLOW-UP TO DETERMINE IF TP CAN PAY MORE AFTER THAT TIME. I ALSO WANT TO PUT SOMETHING IN IA TO INDICATE IF MEDICARE REIMBURSEMENTS OR BANK LOANS TAKE PLACE, IRS WILL GET THE MONEY ... ALSO, I PLAN TO RECOMMEND ABATEMENT OF SOME PENALTY BASED ON THE FACT OF THE UNEXPECTED MEDICARE AUDIT, WHICH RESULTED IN THE CURRENT FINANCIAL PROBLEMS.

R. p. 2135 (emphasis added). Finally, the IRS record of April 20, 1998 confirms that the IRS was planning to "proceed" with the installment agreement and that current payroll deposits had been made by the taxpayers:

> I SW THE POI IN JACKSON AND S. STEVENS LAST WEEK AND BOTH ADVISED THAT THE RETURN WAS FILED. STEVENS PROMISED A COPY BY 4/20 AND I RECEIVED IT TODAY. I WILL COMPLETE CR CHECK AND PROCEED WITH IA. **TP HAS BEEN MAKING CURRENT DEPOSITS.**

R. p. 2137 (emphasis added). The United States does not dispute 1) that the parties agreed to enter into an installment agreement because it was "THE ONLY WAY TO LIQUIDATE LIABILITY," or 2) that the only way to continue business operations to raise the funds to "liquidate liability" necessitates paying the entities' creditors providing goods or services necessary to its operations.

B. Proceedings in The District Court

Davis filed suit to recover amounts he paid toward alleged federal tax liabilities that were assessed against him for the trust fund portion of unpaid employment taxes, including penalties and interest, of the Mynex-Winward entities. The assessment, made pursuant to Section 6672(a) of the Internal Revenue Code, charged Davis as a "person required to collect, truthfully account for, and pay over" employment taxes "who willfully fail[ed] to collect such tax, or truthfully account for and pay over such "and thus "liable to a penalty equal to the amount of the tax evaded, or not collected, or not accounted for and paid over." 26 U.S.C. § 6672(a) (2011).

Davis alleged that he was not a "responsible person" during those relevant time periods, he did

not knowingly or willfully fail to pay such taxes, and the taxes that were assessed against him were inaccurate. In turn, the United States ("IRS") counterclaimed and third-partied Singleton, Pennywell, Williams, and Stevens for those same periods, asserting their liability under Section 6672(a) as well. On August 16, 2002, the IRS assessed Davis, Pennywell, Singleton, Williams, and Stevens, individually, a total of $2,233,514.43 for various tax periods in 1996, 1997 and 1998. Since the dates of assessment, interest has accrued, and the IRS alleges that each individual is responsible as follows: Davis $3,152,862.85; Singleton $3,152,757.49; Pennywell $3,152,438.07; Williams $3,152,757.77; and Stevens $2,210,937.53.

This matter was decided by the District Court for the Western District of Louisiana, Shreveport Division, under federal subject matter jurisdiction 28 U.S.C. §§1331, 1340, 1346, and 26 U.S.C. §7401. On October 7, 2008, the district court granted summary judgment in favor of the United States, finding that Petitioners were responsible persons who had willfully failed to pay over to the IRS the withholding taxes, and thus that they were jointly and severally liable under §6672 for a penalty equal to the amount of the unpaid taxes.

Petitioners timely filed motions for new trial and motions to alter the judgment. On April 17, 2009, the district court denied these motions. Petitioners thereafter timely filed notices of appeal, in compliance with 28 U.S.C. §2107, appealing from a final judgment granting summary judgment in favor of the United States of America on all issues.

C. The Court of Appeals' Decision

This case fell within the Fifth Circuit's appellate jurisdiction pursuant to 28 U.S.C. §1291. On appeal, Petitioners Davis, Singleton, Pennywell, and Williams conceded that they are "responsible persons" within the meaning of §6672 and appealed only whether their failure to remit taxes was "willful." Petitioner Stevens, appealed both the district court's determination that he is a "responsible person" and its determination that he acted "willfully" in not paying the taxes.

Specifically, Petitioners argued in their appeal brief that:

> The contested issues of fact concern the amounts of allegedly unpaid and due taxes, whether taxes for certain periods were paid, whether the IRS applied all credits to which Appellants were entitled, the existence of an agreement with the IRS to continue operations while liquidating the back taxes from operations, **the reliance on the representations and agreements of the IRS**, the reasonableness of the actions taken by Appellants and the lack of later-acquired unencumbered available funds.

Appellants' Appeal Brief, p. iv (emphasis added). Moreover, in reply to the United States' arguments on appeal, Petitioners argued:

> In the instant case, unlike any case previously decided in this Circuit, Appellants contend that **the continuation of the business**, including the payment of its on-going expenses, **was expressly**

> **conditioned upon the agreement of the IRS and made in express reliance on the agreement with the IRS agent. Appellants testified that they acted in reliance on the consent of the IRS to continue to operate the entities while paying the delinquent taxes under the proposed agreement.** Appellants produced records of the IRS approval of the installment agreement proposal and that both the taxpayers and the IRS acted consistently with the consent of the IRS in allowing the entities to operate while the deficiencies were liquidated.

Appellants' Reply to Appellee's Brief, p. 3 (emphasis added).

The United States Court of Appeals for the Fifth Circuit affirmed, finding that Stevens was a "responsible person" and that the Davis Group "willfully" failed to pay over taxes to the IRS. While the court acknowledged that, **"[t]o be sure, the IRS case history notes mention that the parties entered into negotiations about a possible installment agreement, and the revenue officer even states that he planned to recommend the agreement to IRS officials**," the court ultimately found Petitioners "willful" because "[n]either the owners nor Stevens point to any evidence that an installment plan was ever **finalized** ..." *See* Appendix A at pp. 11a-12a (emphasis added).

Petitioners timely filed a Petition for Rehearing, arguing that a finalized installment agreement is not necessary to create a genuine issue of material fact as to Petitioners' willfulness and that their

detrimental reliance on the *on-going negotiations* and *representations* of the IRS with regard to formation of an installment agreement is sufficient to preclude summary judgment in favor of the IRS. Petitioners specifically argued that the Fifth Circuit failed to give credence to the following facts: (1) the significant terms of a pending installment agreement were negotiated and agreed upon by the parties; (2) the terms of the proposed agreement contemplated and allowed the continuation of business operations to facilitate the payment of the past due taxes from future operating revenues; and (3) **Appellants expressly relied on the IRS agent recommendation of the proposed installment agreement in making payments to creditors to continue the business operations as expressly agreed by the parties.** Petition for Panel Rehearing on Behalf of Appellants, pp. 1-2. Petitioners posed the question presented as whether their "reliance on the on-going *negotiations* with and *representations* made by the IRS regarding continuation of business operations and establishment of an installment agreement render summary judgment inappropriate." Petition for Panel Rehearing on Behalf of Appellants, p. 3. Nevertheless, rehearing was denied.

Despite Petitioners' repeated argument that they detrimentally relied on affirmative representations of the IRS regarding the installment agreement and continuation of business operations, the lower courts failed to recognize that the Government may be equitably estopped from assessing the penalty under Section 6672(a). Petitioners were deemed to have willfully failed to pay the delinquent taxes based on the affidavits and evidence of the IRS in support of

its motion for summary judgment that Petitioners paid creditors other than the IRS from and after November 1997-the period of time after discovery and when those very payments were made with the consent and approval of the IRS while the agreement was being negotiated and implemented.

REASONS FOR GRANTING THE WRIT

How can the IRS penalize business owners and officers *not* for doing anything that compromises the Government's collection efforts, but for doing what the Government regards, and encourages, as maximizing its chances of recovery? This conundrum, which plagues a plethora of "responsible persons" throughout the country falling trap to the IRS, raises the question of whether the Government may be equitably estopped, a question which has never been addressed by this Court and which has likewise spawned confusion in the lower courts.

Here, the lower courts decided that the existence of a proposed installment agreement, which expressly contemplated and allowed the entities to continue business operations to generate revenue from which to pay the outstanding taxes, did not present a genuine issue of material fact precluding summary judgment against Petitioners based on their compliance with that pending agreement. Petitioners respectfully submit that the lower courts' decisions directly conflict with this Court's rationale in *Slodov v. United States*, 436 U.S. 238 (1978) and that this Court should grant a writ of certiorari in order to implement uniformity regarding a responsible person's liability under §6672 and when

and how the doctrine of equitable estoppel may be utilized to protect a responsible person from liability. Specifically, if the IRS affirmatively induces the potentially responsible person to undertake certain actions in reliance on the approval of the IRS, the IRS may not thereafter, even if the agreement is not ultimately consummated, use the conduct of the taxpayer taken in express reliance on the approval of the IRS as a basis for a finding of a willful failure to pay the taxes. Such a result taken in good faith and in detrimental reliance on the actions of the IRS is patently unfair to the taxpayers who would otherwise have incurred no personal liability but for the reliance on the agreement of the IRS.

This unfortunate scenario is a major problem affecting taxpayer businesses throughout the country, especially in this violent economic climate marked with struggling and failing businesses. The immensity of the quandary is demonstrated by the National Taxpayer Advocate's 2010 Report to Congress, where she identified the IRS's failure to protect taxpayers suffering an economic hardship as one of the twenty (20) "Most Serious Problems Encountered by Taxpayers"[7] and recommended that Congress revise the "willfulness" component of §6672.[8]

Section 7803(c)(2)(B)(ii)(VIII) of the Internal Revenue Code requires the National Taxpayer Advocate, Nina E. Olson ["the Advocate"], to include

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[7] *See Selections from the National Taxpayer Advocate's 2010 Annual Report to Congress, Volume One,* Appendix F, pp. 53a-83a.

[8] Appendix F, pp. 84a-98a.

in her Annual Report to Congress legislative recommendations to resolve problems encountered by taxpayers. In her 2010 Annual Report to Congress, one (1) of the eleven (11) legislative recommendations made by the Advocate was to revise the willfulness component under §6672.[9] The Advocate surmised:

> ...courts have adopted a rather 'harsh' interpretation of the willfulness component of the statute in situations where there was no change in ownership. To avoid TFRP [Trust Fund Recovery Penalty under §6672] liability, a responsible person must use all available funds to pay off back trust fund taxes and cannot use any portion of after-acquired funds as a working capital to pay current operating expenses, even if it may result in liquidation of the business ... **Because the assessment of the TFRP can have disastrous economic consequences on those deemed responsible, this rule provides a disincentive for keeping financially struggling businesses afloat by paying businesses' operating expenses and current employment tax liabilities, while repaying past delinquencies in installments.**

Appendix F, pp. 86a-87a (emphasis added) (internal citations omitted). Further, in the section of her report entitled "Reasons for Change," the Advocate reported:

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[9] *Id.*

...The taxpayer's willfulness is generally established if he or she pays other creditors instead of paying the IRS ... even if those payments are made in an effort to keep the business going. **Thus, during a period of financial hardship, a responsible person must always continue to repay back taxes even when funds to operate the business are not available.**

Courts and legal scholars have commented that the current judicial interpretation of willfulness is "harsh," "draconian," and "somewhat counterintuitive," and advocated for change in the statute. This interpretation appears to cause unjust results when a responsible person of a struggling business tries to resolve past tax delinquency, which resulted from an intervening bad act, and agrees to repay the liability in installments instead of liquidating the business. ...

...It is in the best interests of the government to encourage business owners to continue in business and pay off the delinquencies in installments rather than liquidate and lay off employees. *Because current judicial interpretation of the TFRP willfulness component effectively requires a business owner to stop operating a business and pay all available cash to the IRS, the government may be forced to make outlays in the form of unemployment benefits, food stamps, and the like to the business owner and the laid-off employees.* **Thus, the**

> **strict application of the TFRP willfulness component has the potential to destroy the taxpayer's business, financially damage the taxpayer's family, and simultaneously reduce future federal revenue.**

Appendix F, pp. 94a-96a (internal citations omitted) (emphasis added).

For example, in *Buffalow v. United States*, 109 F.3d 570, 573 (9th Cir. 1997), the president and sole shareholder of a corporation, Mr. Buffalow, appealed the district court's judgment in favor of the United States in which the court determined that he was responsible for a penalty under § 6672(a) for the failure to pay over employment taxes in 1989 and 1990. In the latter part of 1990, he discovered that the company was having cash flow problems, and he asked the company's controller to prepare a report of accounts payable, including any unpaid tax obligations. The controller did so, but did not tell Buffalow that there were unpaid federal employment tax liabilities. The controller then left the company and disappeared. After the controller left, Buffalow received a notice from the IRS. He investigated, and by the end of February 1990 he discovered that the IRS was correct. For that reason, among others, he determined that the company could not survive and would have to be closed.

The company, however, did have some valuable assets in the form of preventative maintenance contracts and a customer list. As he saw it, those assets would have zero value if the company simply closed its doors immediately. He decided that the wisest economic plan for all concerned was to keep

the company in operation while he found buyers for those assets. Once the assets were sold, the secured debts could be paid, and what was left could be allocated to the tax liabilities. Of course, if the company were to stay open, amounts would have to be paid out for vendors and for operating expenses (including current wages) during the interim.

Mr. Buffalow thereafter wrote to the IRS revenue officer and explained what he planned to do. The IRS officer did not warn him that he was stepping into a tax quagmire. Instead, she simply asked him to keep her informed and to keep up payment of the ensuing payroll taxes for sure. He proceeded to carry out his plan and had some success. The company did stay afloat long enough to sell some assets, pay current taxes, repay the secured debt, and pay about $100,000 on the company's accrued tax liabilities.

Once the dust had settled, the IRS assessed Mr. Buffalow personally for the unpaid employee withholding tax liabilities on the theory that he was a responsible officer who had willfully failed to pay over those taxes. The district court granted summary judgment in favor of the IRS and Mr. Buffalow appealed, arguing that he should not be personally liable for the unpaid withholding taxes because he did not "willfully" fail to pay them over. Buffalow's arguments were two-fold: (1) that he was trying to ultimately rescue something for the government, and his acts should not be considered willful because rescue operations should be encouraged; and (2) the IRS is equitably estopped because the revenue officer approved and encouraged him to keep the business going and

behaved in a manner that led him to believe that the IRS would not seek to hold him personally responsible for the taxes. However, the Ninth Circuit affirmed the judgment of the district court, despite its recognition of the harsh and counter-intuitive application of Section 6672, noting that Mr. Buffalow would "have been better off had he shut down the company immediately rather than making a good faith effort to maximize the money available to all creditors, including the government." *Id.* at 575, n. 3; *see also, Phillips v. U.S. I.R.S.*, 73 F.3d 939, 943 (9th Cir. 1996) (precedents establish IRS' draconian enforcement power under Section 6672); Corrie Lynn Lyle, *The Wrath of IRC § 6672: The Renewed Call for Change – Is Anyone Listening? If You Are a Corporate Official, You Had Better Be*, 74 S.Cal.L.Rev. 1133, 1139 (May 2001) ("Judges have often commented that the results may be harsh and the powers of the IRS 'draconian.'").

In light of the prevalence of such unjust, unreasonable and inequitable circumstances in this failing economy, as recognized by the National Taxpayer Advocate in her 2010 Report to Congress, Petitioners respectfully submit that now is the time for this Court to finally address the lower courts' harsh, draconian and counterintuitive interpretations of §6672(a), which have generated disastrous results, and to delineate when the IRS may be equitably estopped from seeking penalties under §6672(a).

A. The Applicable Law

Sections 3102 and 3402 of the Internal Revenue Code require employers to withhold federal social security and income taxes from the wages of their

employees. 26 U.S.C. § § 3102, 3402 (2011). Once taxes are collected, they become a trust fund in the hands of the employer. 26 U.S.C. §7501 (2011). Section 6672 provides that when a person required to collect, account for, and pay over withholding taxes willfully fails to do so, he is liable for a penalty equal to the amount of the unpaid taxes. 26 U.S.C. §6672(a) (2011).

The courts of appeals have developed a bright-line rule that a voluntary, conscious, and intentional act to prefer other creditors over the United States constitutes willful failure to pay over withholding taxes. *See, e.g., Teel v. United States*, 529 F.2d 903, 905 (9th Cir. 1976); *Hochstein v. United States*, 900 F.2d 543, 548 (2d Cir. 1990); *Mazo v. United States*, 591 F.2d 1151, 1157 (5th Cir. 1979); *United States v. Vespe*, 868 F.2d 1328, 1335 (3d Cir. 1989); *Thibodeau v. United States*, 828 F.2d 1499, 1506 (11th Cir. 1987); *Caterino v. United States*, 794 F.2d 1, 6 (1st Cir. 1986); *Olsen v. United States*, 952 F.2d 236, 240 (8th Cir. 1991). The individual's bad motive or evil intent in failing to collect and pay the taxes need not be shown. *See, e.g., Mazo*, 591 F.2d at 1155. In fact, the willfulness requirement is satisfied if the responsible person acts with a reckless disregard of a known or obvious risk that trust funds may not be remitted to the Government. *Id.*; *George v. United States*, 819 F.2d 1008 (11th Cir. 1987); *Denbo v. United States*, 988 F.2d 1029 (10th Cir. 1993); *Honey v. United States*, 963 F.2d 1083 (8th Cir. 1992); *Godfrey v. United States*, 748 F.2d 1568 (Fed. Cir. 1984); *Phillips v. U.S. I.R.S.*, 73 F.3d 939, 942 (9th Cir. 1996); *Kalb v. United States*, 505 F.2d 506, 511 (2d Cir. 1974); *Sawyer v. United States*, 831 F.2d 755, 758 (7th Cir. 1987).

B. This Court's Rationale in *Slodov* Has Been Ignored, or At Least Thwarted, by the Lower Courts.

In *Slodov*,[10] the IRS filed a claim for federal income and social security taxes which had been withheld from the wages of corporate employees but had not been paid to the Government. The court of appeals held that an individual who assumed control of the corporations shortly before they filed for bankruptcy was personally liable for the unpaid taxes. This Court granted certiorari and held, among other things, that Section 6672 was not intended to impose absolute liability without personal fault. In so holding, this Court reasoned that imposing liability under the circumstances would frustrate the purpose of §6672, which promotes the full collection of taxes. At the time the petitioner assumed control, the corporations owed back taxes, were overdue on their supplier accounts, and had no cash. This Court noted:

> The Government admits that in such circumstances, the IRS's practice is to be 'flexible,' and does not insist that the corporation discontinue operations, thereby substituting for certain loss at least the potential of recovery of back taxes if the corporation makes a financial recovery.
>
> ...
>
> Thus, although it is in the IRS's interest to encourage the responsible person to

[10] 436 U.S. 238.

> continue operation with the hope of receiving payment of the back taxes, if the attempt fails and the taxes remain unpaid, the IRS insists that the §6672 personal-liability penalty attached upon payment of the first dollar to a supplier.[11]

This Court further acknowledged:

> When immediate filing for bankruptcy means a total loss, the Government understandably ... does not discourage the corporation from continuing to operate so long as current taxes are paid. **As soon as the corporation embarks upon that course, however, the "responsible person" is potentially liable to heavy civil and criminal penalties *not for doing anything which compromised the Government's collection efforts, but for doing what the Government regards as maximizing its chances for recovery.***[12]

This Court ultimately concluded that the tax code's language and legislative history are inconsistent with a penalty theory that imposed liability without personal fault:

> Section 6672 cannot be read as imposing upon the responsible person an absolute duty to "pay over" amounts which should have been collected and withheld. The fact that the provision imposes a 'penalty' and is violated only by a 'willful failure' is itself

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[11] *Id.* at 252.

[12] *Id.* at 253 (emphasis added).

> strong evidence that it was not intended to impose liability without personal fault.[13]

This Court's rationale in *Slodov* with regard to the non-penal nature of §6672 and the Section's purpose of facilitating collection of funds prohibits the lower courts' granting of summary judgment in favor of the IRS in the face of a negotiated, pending installment agreement which expressly contemplated the continuation of business operations. The effect of granting summary judgment in this case, as this Court noted in *Slodov*, is that the Petitioners are held liable to heavy civil penalties ***not*** *for doing anything which compromised the Government's collection efforts, but for doing what the Government regards, and encourages, as maximizing its chances for recovery.*[14]

C. This Court Must Intervene and Hold that the Government may be Equitably Estopped in a Section 6672(a) Action Where the "Responsible Person" Detrimentally Relied on Affirmative Representations Made by an IRS Agent.

Although this Court has held that the tax code's language and legislative history are inconsistent with a penalty theory that imposed "liability without personal fault," this Court has never decided whether an equitable estoppel claim may succeed against the Government and under what circumstances. This question is ripe for decision in light of the confusion in the circuits and prevalence

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[13] *Id.* at 254.

[14] *Id.* at 253.

of installment agreements due to the IRS's policy of allowing continuation of operations so as to ensure a greater chance of repayment of taxes.

This Court has never decided whether an estoppel claim could ever succeed against the Government, although its opinions have mentioned the possibility that some type of affirmative Governmental conduct might give rise to estoppel. *Office of Personnel Management v. Richmond*, 496 U.S. 414, 421 (1990) (citing *INS v. Hibi*, 414 U.S. 5, 8 (1973) (per curiam) ("While the issue of whether 'affirmative misconduct' on the part of the Government might estop it from denying citizenship was left open in *Montana v. Kennedy*, 366 U.S. 308, 314-315 (1961), no conduct of the sort there adverted to was involved here."); *Schweiker v. Hansen*, 450. U.S. 785 (1981) (per curiam) (denying an estoppel claim for Social Security benefits, but observing that the Court has never decided what type of conduct will estop the Government); *INS v. Miranda*, 459 U.S. 14, 19 (1982) (per curiam); *Heckler v. Community Health Services of Crawford County, Inc.*, 467 U.S. 51, 60 (1984)). Although the question has been frequently presented, this Court has routinely declined to answer it. Indeed, in 1981 Justice Marshall commented that:

> The question of when the Government may be equitably estopped has divided the distinguished panel of the Court of Appeals in this case, has received **inconsistent treatment** from other Courts of Appeals, and has been the subject of considerable ferment ...The apparent message of today's decision – that we will know an estoppel

> when we see one – provides **inadequate guidance to the lower courts** in an area of the law that, contrary to the majority's view, is far from settled.

Schweiker, 450 U.S. at 791 (Marshall, J., dissenting) (emphasis added). Further, in 1990, this Court, through Justice Kennedy, acknowledged:

> The language in our decisions has spawned **numerous claims** for equitable estoppel in the lower courts .... Since [Justice Marshall's dissent in *Schweiker*], federal courts have continued to accept estoppel claims under a variety of rationales and analyses. In sum, Courts of Appeals have taken our statements as an invitation to search for an appropriate case in which to apply estoppel against the Government ... **The extraordinary number of such dispositions in this single area of the law provides a good indication that our approach to these cases has provided inadequate guidance for the federal courts and served only to invite and prolong needless litigation.**

Office of Personnel Management, 496 U.S. at 422 (emphasis added). However, this Court again decided to "...leave for another day whether an estoppel claim could ever succeed against the Government," despite its agreement "that this case should be decided under a clearer form of analysis than 'we will know an estoppel when we see one.'" *Id.* at 423. Petitioners respectfully submit that this Court must finally address this issue and decide

when and how a claim for estoppel may succeed against the Government.

The confusion in the lower courts is palpable. While equitable estoppel has been applied against the Government in some cases,[15] attempts to estop the Government have generally been unsuccessful in the lower courts because "[i]t is far from clear that the Supreme Court would ever allow an estoppel defense against the government under any set of circumstances." *Logan Farms, Inc. v. Espy*, 886 F.Supp. 781, 790 (D. Kan. 1995) (quoting *FDIC v. Hulsey*, 22 F.3d 1472, 1490 (10th Cir. 1994)). **In fact, the Fifth Circuit recently acknowledged its "longstanding presumption that estoppel against the government is impermissible."** *United States v. Southland Management Corp.*, 288 F.3d 665, 682 (5th Cir. 2002).

On the other hand, courts of appeals which have applied estoppel against the Government have held that before the Government may be estopped, the aggrieved party must demonstrate "affirmative conduct going beyond mere negligence," and must also show "that the government's act will cause a serious injustice and the imposition of estoppel will not unduly harm the public interest." *Purcell v. United States*, 1 F.3d 932, 939 (9th Cir. 1993) (citing

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[15] *See, e.g., Corniel-Rodriquez v. INS*, 532 F.2d 301 (2d Cir. 1976); *United States v. Lazy FC Ranch*, 481 F.2d 985 (9th Cir. 1973); *United States v. Fox Lake State Bank*, 366 F.2d 962 (7th Cir. 1966); *Walsonavich v. United States*, 335 F.2d 96 (3d Cir. 1964); *Semaan v. Mumford*, 335 F.2d 704 (D.C. Cir. 1964), *abrogated on other grounds*; *Eichelberger v. Commissioner of Internal Revenue*, 88 F.2d 874 (5th Cir. 1937).

S & M Investment Co. v. Tahoe Regional Planning Agency, 911 F.2d 324, 329 (9th Cir. 1990)). In fact, several courts of appeals have applied the doctrine of estoppel to the IRS under various circumstances. *See, e.g.*, *Fredericks v. C.I.R.*, 126 F.3d 433 (3d Cir. 1997) (holding IRS equitably estopped from relying on Form 872-A to extend the statute of limitations where IRS misrepresented its possession of the form); *Miller v. United States*, 500 F.2d 1007 (2d Cir. 1974) (IRS estopped from relying on a statute of limitations contained in a previously signed waiver-of-notice form as a bar to taxpayer's refund claim, where IRS erroneously disregarded the waiver, unnecessarily issued notice to taxpayer and, pursuant to the notice, the statute of limitations had not run); *Schuster v. C.I.R.*, 312 F.2d 311 (9th Cir. 1962) (IRS estopped from correcting prior erroneous determination of estate tax where bank relied on that determination and disposed of the affected assets); *United States v. Brown*, 86 F.2d 798 (6th Cir. 1936) (IRS, after exercising choice to pursue one of two available remedies while letting alternative theory "slumber in the files," is bound by that choice and cannot later pursue the inconsistent alternative remedy). *Contrast*, *Buffalow*, 109 F.3d 570 (IRS not estopped from asserting penalty on responsible person even though IRS officer encouraged president to keep business going and behaved in a manner which led the responsible person to believe that the IRS would not seek to hold him personally responsible for the taxes).

In a case remarkably similar to the instant action, the court held that fact issues remained as to whether the IRS was estopped by an installment agreement from seeking penalties against a

responsible person. *Baimbridge v. United States*, 335 F.Supp.2d 1084 (S.D. Cal. 2004). The responsible person argued that the Government should not be able to enter into an installment agreement, which clearly contemplated the taxpayer corporation's continued operation and payments to non-IRS creditors, and then assess tax penalties against the responsible person for attempting to follow that arrangement. The court found that, in viewing the evidence in a light most favorable to the "responsible person," a genuine issue of material fact existed because the IRS agent negotiated an installment agreement with the responsible person which required him to submit monthly payments for past delinquencies while continuing to operate his business. The court reasoned that, at a minimum, there was a material issue as to whether the Government engaged in affirmative misconduct by entering into such an agreement, knowing that by adhering to it the responsible person would expose himself to penalties under §6672. The court further reasoned that:

> ...there can be no question that serious injustice may result from a penalty assessment being predicated on non-IRS payments which were contemplated by the installment agreement. Finally, the Court sees no reason why estoppel would unduly harm the public interest. To the contrary, if the government escapes estoppel here, the IRS's ability to use installment agreements would be severely diminished by a well-founded fear among taxpayers that such

> agreements will be used against them in the future.[16]

The court then determined that the responsible person detrimentally relied on a misrepresentation when he entered the installment agreement and continued business operations as contemplated by the agreement.

The court's decision in *Baimbridge* is well-founded and should be reinforced by the decision of this Court here. After all, "[i]t has been well said that the government should always be a gentleman. Taxpayers expect, and are entitled to receive, ordinary fair play from tax officials." *Stockstrom v. C.I.R.*, 190 F.2d 283, 289 (D.C. Cir. 1951). The law cannot be that a taxpayer acting in reliance on the negotiated terms of a pending installment agreement, which lawfully allows a taxpayer to pay creditors other than the IRS, is liable as a matter of law for penalties under §6672(a). Indeed, this Court's rationale in *Slodov* prohibits such an interpretation which frustrates the purpose of Section 6672 and imposes liability without personal fault.

It is undisputed that the Davis Group did not learn of the payroll tax problems until November of 1997, and then immediately undertook a course of action to ensure the timely payment of all employee tax obligations. On November 12, 1997, Stevens contacted Carrie Carbo at the IRS and proposed an installment agreement for the entities. The evidence shows that the IRS allowed the entities to continue

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[16] *Baimbridge*, 335 F.Supp.2d at 1092.

to operate pursuant to the agreement first for 90 days and then thereafter.

Petitioners submitted competent evidence to the lower courts of the proposal and acknowledgment of the existence of the agreement by the IRS agent in charge. R. pp. 1473, 1505, 1506, 1577-80, 1933-36, 1939-40, 1965, 2134-35, 2137. Moreover, this evidence was corroborated by the affidavits and testimony of Petitioners. R. pp. *id.*, 2071-75, 2086-89, 2101-05, 2116-20. Contemporaneous written records of the IRS confirm the mutual intent and corroborate the reliance of the taxpayers on the fact that the agreement was approved by the field agent and would be recommended up the channels of authority in the IRS to whatever level had ultimate approval and signatory authority. While the pending installment agreement was slowly roaming the halls of the IRS, Petitioners were left in a confounding position: a) withhold payment from creditors and go out of business, leaving the IRS at a reduced chance of recovering the monies owed; or b) continue to make payments to other creditors in addition to the IRS, so as to continue business operations and honor the pending, negotiated installment agreement. The IRS no doubt expected, and encouraged, Petitioners to comply with the terms of the pending installment agreement, including continuation of business operations and payments to creditors; otherwise the company would find itself bankrupt and the pending installment agreement would be moot by the time it was formally affected. Indeed, the very nature of such an agreement is to allow a taxpayer to continue to operate and generate funds from which to pay both its current and delinquent tax liabilities.

Petitioners detrimentally relied on the IRS in continuing operations as was expressly contemplated. Petitioners testified that they acted in reliance on the consent of the IRS to continue to operate the entities while paying the delinquent taxes under the proposed agreement. Petitioners produced records of the IRS approval of the installment agreement proposal and that both the taxpayers and the IRS acted consistent with the consent of the IRS in allowing the entities to operate while the deficiencies were liquidated. Finally, Petitioners submitted affidavits attesting to the fact that had they known that continuing business operations in furtherance of the pending installment agreement would subject them to personal liability under §6672(a), they would have simply closed the doors and avoided personal liability.

At the very least, viewing the evidence in a light most favorable to Petitioners, a genuine issue of material fact exists as to whether the Government engaged in affirmative misconduct by negotiating such an agreement, knowing that by adhering to it Petitioners would expose themselves to penalties.

CONCLUSION

For the foregoing reasons, this Court should grant Petitioners' petition for writ of certiorari, review and reverse the Court of Appeals for the Fifth Circuit's order affirming the district court's granting of summary judgment in favor of the United States, reverse the judgment of the district court and remand, finding genuine issues of material fact exist as to whether the IRS is equitably estopped and

whether Petitioners were "willful" within the meaning of §6672(a).

Respectfully submitted,

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APRIL 2011

APPENDIX A

IN THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 09-30392

[U.S. Court of Appeals
Fifth Circuit
Filed November 22, 2010
Lyle W. Cayce, Clerk]

S. P. DAVIS, SR.,

Plaintiff–Counter Defendant–Appellant,

v.

UNITED STATES OF AMERICA,

Defendant–Counter Claimant–Appellee,

v.

WILLIE J. SINGLETON; PHILLIP PENNYWELL, JR.; JAMES C. WILLIAMS; SAMUEL W. STEVENS, III,

Counter Defendants–Appellants.

Appeals from the United States District Court for the Western District of Louisiana USDC No. 5:06-CV-158

Before REAVLEY, PRADO, and OWEN, Circuit Judges.

PER CURIAM:*

S. P. Davis, Sr., Willie J. Singleton, Phillip Pennywell, Jr., James C. Williams, and Samuel Stevens, III, appeal the district court's grant of summary judgment in favor of the United States. The appellants argue that the district court erred in ruling that the appellants were liable for failing to remit to the United States certain employment taxes withheld from the wages of employees at three companies. We affirm.

I

Davis, Singleton, Pennywell, and Williams (jointly, the owners) were equal owners, officers, and members of the board of Winward Institute, doing business as Winward Hospital (Hospital), Winward Health Care Center (Clinic), and Mynex (together, the companies). The Hospital and Clinic provided medical services to Louisiana patients. Mynex provided the Hospital and Clinic with management, transportation, therapy, and marketing services, as well as pharmaceutical services and products.

Mynex's management division provided the officers, vice presidents, and all accounting

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*Pursuant to 5TH CIR. R. 47.5, the court has determined that this opinion should not be published and is not precedent except under the limited circumstances set forth in 5TH CIR. R. 47.5.4.

functions—including, but not limited to, payroll, billing and accounts receivable, accounts payable, and reporting—for the companies. From 1997 onward, Stevens served as the vice president of finance for Mynex. Stevens initially reported to Dan Reid, the executive vice president of Mynex, but when Reid left at the end of 1997, Stevens reported directly to the board.

The Hospital generated most of its income through Medicare and Medicaid payments. In 1997, after Medicare reduced its reimbursement rates and an audit determined that the Hospital had been overpaid by Medicare, the Hospital experienced significant financial problems. These problems led it to cut staff and implement a number of other cost-cutting measures. The Hospital also entered into a financing agreement with Daiwa, a financial services company, under which Daiwa provided periodic loans to the Hospital equal to a portion of the Hospital's accounts receivable.

Shortly after his hiring, Stevens learned that the companies were delinquent in the payment of their federal trust fund taxes. The owners learned of the payroll tax problems in the fall of 1997, when a paralegal discovered in a local legal publication that a federal tax lien had been filed against the companies. After becoming aware of the tax problems, the owners met with Stevens and Reid and instructed them never to fall behind in paying payroll taxes again. The owners told Stevens to contact the Internal Revenue Service (IRS), determine the amount of tax liability,

negotiate a payment agreement, and report back to the board. Stevens communicated with the IRS and later reported to the board that he had entered into an installment agreement with the IRS concerning the companies' delinquent taxes and that current payroll taxes were being properly paid.

The parties dispute whether the IRS and the companies actually entered into an installment agreement. The record shows that Stevens sent the IRS a proposed agreement regarding the Hospital's and Mynex's overdue taxes. Stevens had multiple conversations with an IRS revenue officer about a possible installment agreement. The IRS case history notes show that the IRS revenue officer repeatedly requested, and was awaiting, information from the companies. There is no evidence, however, that an installment agreement was ultimately consummated.

Throughout this time, the companies continued to make payments to outside creditors other than the IRS. Stevens admitted that, beyond discussing the matter with the IRS, he did nothing to ensure that the companies' payroll taxes were being timely paid.

In the spring of 1998, the Hospital's creditors filed an involuntary bankruptcy petition under Chapter 7 of the Bankruptcy Code, which was later converted to a voluntary Chapter 11 proceeding. After the filing, the owners learned that Stevens had failed to correct the payroll tax deficiencies. The Hospital continued as a debtor-in-possession until a Chapter 11 trustee was appointed in the summer of 1998. The

bankruptcy was subsequently converted back to a Chapter 7 proceeding and was terminated in 2006.

Pursuant to Internal Revenue Code § 6672(a), the IRS issued assessments against the appellants for the companies' unpaid trust fund portions of federal employment taxes. Stevens was assessed $2,210,937.53, while each owner was assessed $2,233,514.43. Davis paid a portion of the assessment and filed for a refund with the IRS. When the claim was denied, Davis filed this suit to recover the amounts paid. The United States counterclaimed, and also filed suit against Singleton, Pennywell, Williams, and Stevens, for the full amounts assessed, plus interest and penalties. All of the defendants denied liability for the unpaid taxes.

The district court granted summary judgment in favor of the United States, finding that the owners and Stevens were responsible persons who had willfully failed to pay over to the United States the withholding taxes, and thus that they were jointly and severally liable under § 6672 for a penalty equal to the amount of the unpaid taxes. This appeal followed.

II

We review a district court's grant of summary judgment de novo, applying the same standards as the district court.[1] Summary judgment is proper when

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[1] *Travelers Lloyds Ins. Co. v. Pac. Emp'rs Ins. Co.*, 602 F.3d 677, 681 (5th Cir. 2010).

there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law.[2]

Employers are required to withhold federal social security and income taxes from their employees' wages and to pay these taxes to the IRS.[3] These withholdings are held in a special trust fund for the benefit of the United States.[4] Each employee is considered to have paid the taxes, even if the employer has failed to pay over the funds to the United States.[5] "When a corporate employer neglects to pay the required taxes, section 6672(a) authorizes the Government to assess the full amount of taxes due against the corporation's responsible officers in the form of a penalty."[6] Section 6672(a) provides that

> [a]ny person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to

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[2] FED. R. CIV. P. 56(c).

[3] I.R.C. §§ 3102(a), 3402(a).

[4] *See Howard v. United States*, 711 F.2d 729, 733 (5th Cir. 1983) (citing I.R.C. § 7501).

[5] *Id.*

[6] *Id.*

> evade or defeat any such tax or the payment thereof, shall . . . be liable for a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.

We have held that § 6672(a) imposes two requirements for liability: "the person must be a 'responsible person' and the person must act 'willfully' in not paying the taxes."[7]

Conceding that they are responsible persons, the owners contest only whether their failure to remit taxes was willful. Stevens, however, contests both the district court's determination that he is a responsible person and its determination that he acted willfully in not paying the taxes due.

A

To serve the prophylactic purpose of encouraging "officers, directors, and other high-level employees to stay abreast of [a] company's withholding and payment" of payroll taxes, we take a broad view of who is a "responsible person" under § 6672(a).[8] Any person who has the "status, duty[,] and authority to

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[7] *Wood v. United States*, 808 F.2d 411, 414 (5th Cir. 1987) (citing *Brown v. United States*, 591 F.2d 1136, 1139-40 (5th Cir. 1979)).

[8] *Logal v. United States*, 195 F.3d 229, 232 (5th Cir. 1999) (citing *Barnett v. IRS*, 988 F.2d 1449, 1454, 1457 (5th Cir. 1993)).

pay the taxes owed" is a responsible person.[9] An individual may be a responsible person even if he is not the person *most* responsible for the payment of taxes.[10] "There may be—indeed, there usually are—multiple responsible persons in any company."[11] The "crucial inquiry" is whether a person, "by virtue of his position in (or vis-a-vis) the company, could have had substantial input into such decisions, had he wished to exert his authority."[12]

We have little trouble concluding that Stevens is a responsible person under § 6672(a). As vice president of Mynex, Stevens—by his own admission—authorized payroll checks, prepared federal payroll tax returns, authorized payment of federal tax deposits, reviewed federal income tax returns, directed the payment of bills, dealt with major suppliers and customers, negotiated large corporate purchases, contracts, and loans, and determined company financial policy. He also headed the Mynex accounting department, which provided all accounting functions, including billing and reporting, for the Hospital and the Clinic. He represented the companies in communications with the IRS. These undisputed facts are ample evidence that Stevens was a responsible person—that is, he could have had

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[9] *Howard*, 711 F.2d at 734.

[10] *Barnett*, 988 F.2d at 1455 (citing *Howard*, 711 F.2d at 737).

[11] *Id.*

[12] *Id.* (internal quotation marks omitted).

substantial input into the decision whether to withhold and pay the trust fund taxes, had he wished to exert this authority.

Stevens argues that he was not a responsible person because he did not satisfy a sufficient number of the six indicia of responsible person status set out in *Barnett v. IRS.*[13] This position fails because "n]o single factor is dispositive."[14] The record shows that Stevens had significant authority over the relevant day-to-day operations of the company, he had the authority to hire at least some employees, and he made decisions about the disbursement of funds. Most importantly, the record clearly shows that Stevens was intimately involved in the process of determining and paying the payroll taxes and thus could have had substantial input into decisions on this matter. For that reason, he is a responsible person within the meaning of § 6672(a).

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[13] *Id.* ("The factors we consider are indicia [of a person's authority over an enterprise's financial or general decisionmaking]. We ask whether such a person:

> (i) is an officer or member of the board of directors; (ii) owns a substantial amount of stock in the company; (iii) manages the day-to-day operations of the business; (iv) has the authority to hire or fire employees; (v) makes decisions as to the disbursement of funds and payment of creditors; and (vi) possesses the authority to sign company checks.).

[14] *Id.*

B

In order to be liable for the penalty under § 6672(a), a responsible person must also have acted willfully in failing to pay the taxes due.[15] "Willfulness requires merely a voluntary, conscious, and intentional act; a bad motive or evil intent is not necessary."[16] A "responsible person acts willfully if he knows the taxes are due but uses corporate funds to pay other creditors, or if he recklessly disregards the risk that the taxes may not be remitted to the government."[17] Although the willfulness inquiry is usually a factual question, "evidence that the responsible person had knowledge of payments to other creditors after he was aware of the failure to pay withholding tax is sufficient for summary judgment on the question of willfulness."[18]

Stevens became aware of the tax deficiencies in early 1997, and the owners learned of the deficiencies in the fall of 1997. Despite this knowledge, the companies continued to make payments to employees and outside creditors. The owners continued to sign checks presented to them by the accounting department for payments to creditors. Moreover,

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[15] *Wood v. United States*, 808 F.2d 411, 414 (5th Cir. 1987).

[16] *Id.* at 415.

[17] *Logal v. United States*, 195 F.3d 229, 232 (5th Cir. 1999) (internal citations omitted).

[18] *Mazo v. United States*, 591 F.2d 1151, 1157 (5th Cir. 1979).

Stevens admitted that he and the owners authorized payments to Medicare, Daiwa, vendors, and employees while the delinquent taxes were accruing. These are precisely the kinds of actions that we have found to demonstrate willfulness under § 6672(a).[19]

The owners and Stevens present a number of unavailing reasons they should not be considered to have acted willfully in failing to pay the trust fund taxes. First, they argue that an installment agreement existed between the IRS and the companies, allowing the companies to continue operating while paying the delinquent taxes over time. If an agreement existed, the owners and Stevens could not be liable for willfully failing to pay the trust fund taxes, as long as they complied with the terms of the agreement.

Once the Government offers an assessment into evidence, the burden of proof to show an absence of willfulness lies with the responsible person.[20] Therefore, in order to avoid summary judgment, the owners and Stevens must show there is a genuine issue of material fact concerning whether an installment agreement existed. They have failed to do so. To be sure, the IRS case history notes mention that the parties entered into negotiations about a possible installment agreement, and the revenue officer even states that he planned to recommend the agreement to

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[19] *Id.* at 1156-57.

[20] *Barnett v. IRS*, 988 F.2d 1449, 1453 (5th Cir. 1993) (internal citations omitted).

IRS officials. But there is no evidence that the negotiations led to an agreement, and the case history notes demonstrate that the revenue officer repeatedly requested, and was awaiting receipt of, additional information from the companies. Neither the owners nor Stevens point to any evidence that an installment payment plan was ever finalized, beyond their own bare assertions of that fact. Such assertions are insufficient to create a genuine issue of material fact.[21]

Moreover, even if an installment agreement existed, it is clear that the companies did not abide by it. Stevens testified that, under the agreement, the companies were required to keep current with newly arising taxes and to gradually pay the past-due employment taxes. But the record shows that the companies fell further behind in paying the employment taxes due in the first three quarters of 1998. There is also no evidence that the companies made progress on paying the delinquent taxes.

The owners argue that they made reasonable efforts to see that the trust funds were paid, instructing Stevens and Reid to rectify the problem at an emergency board meeting held immediately after the owners learned of the tax problems. While we recognize that "reasonable cause may excuse the failure to collect, account for, or pay over withholding taxes, the mere delegation of responsibility to another

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[21] *See Eugene v. Alief Indep. Sch. Dist.*, 65 F.3d 1299, 1305 (5th Cir. 1995) (A "bare allegation, unsupported by any evidence, is not sufficient to defeat summary judgment.").

does not constitute reasonable cause."[22] Neither does the owners' reliance on Stevens' representations that he entered into an installment agreement with the IRS constitute reasonable cause. Indeed, in *Mazo*, we determined that the defendants' reliance on representations by the company controller that he had or would address the company's tax problems was insufficient to create an genuine issue of material fact with regard to willfulness.[23]

The owners also argue that, after they learned of the tax liabilities, the taxes could not be paid because the companies' later-acquired funds were encumbered, first by the financing agreement with Daiwa and later by the bankruptcy. The burden to prove that funds are encumbered falls on the owners, as that issue is part of the larger willfulness inquiry.[24] The owners again fail to point to any evidence—aside from their bare assertions—that disbursements were controlled by Daiwa. Indeed, by Stevens' admission, he and the owners continued to authorize payments to Medicare, Daiwa, vendors, and employees while the delinquent taxes were accruing. The owners also fail to show that later-acquired funds were encumbered by the bankruptcy. Again, the record shows just the opposite: while acting as a debtor-in-possession, the Hospital petitioned the bankruptcy court for authority

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[22] *Mazo*, 591 F.2d at 1155 (internal citation omitted).

[23] *Id.* at 1157.

[24] *Barnett*, 988 F.2d at 1458.

to pay Stevens and received its approval. The owners could have petitioned the court for authority to pay the trust fund taxes instead.[25] The owners have failed to show the existence of any encumbrance preventing the companies from paying the IRS.

Finally, the owners assert that a genuine issue of material fact exists regarding whether the assessments were properly calculated. An IRS certificate of assessment provides presumptive proof of the validity of the assessments,[26] and the taxpayer has the burden of overcoming that presumption of correctness.[27] Here, the evidence relied upon by the owners—a lone notation in the IRS case history notes indicating that a case against the Hospital was closed in the spring of 1997—is wholly insufficient to overcome that burden, especially when the same case history notes later indicate that the case was re-opened later that year. No question of material fact exists with regard to the correctness of the assessments.

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[25] *See Cook v. United States*, 52 Fed. Cl. 62, 71-72 (Fed. Cl. 2002) (holding that a corporation's entry into bankruptcy did not prevent a finding of willful failure to pay taxes when the bankruptcy court had authorized other expenditures).

[26] *United States v. McCallum*, 970 F.2d 66, 71 (5th Cir. 1992).

[27] *Mersel v. United States*, 420 F.2d 517, 518 (5th Cir. 1969).

III

The owners argue that they could not properly defend this case because the bankruptcy trustee destroyed the companies' records. They assert that an adverse inference should be drawn against the IRS, that is, that exculpatory evidence existed within the corporate records that would have corroborated the testimony of the owners and Stevens. We disagree. The bankruptcy trustee certified that his motion to destroy the documents was noticed to Davis and Singleton, and there is no evidence that the owners opposed the trustee's motion. On these facts, we cannot agree that an adverse inference should be drawn against the IRS, as such an inference would effectively shift the burden of proof from the taxpayer to the IRS.

Finally, because we base our conclusion that Stevens is a responsible person on his own admissions,[28] his contention that the document destruction prevented him from proving he was not such a person is meritless. So, too, is his request for sanctions against the United States, as the records were destroyed pursuant to a valid court order by the bankruptcy trustee, not the IRS.

* * *

For the foregoing reasons, we AFFIRM the district court's grant of summary judgment in favor of the United States.

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[28] R.A. *supra*.

APPENDIX B

United States District Court

Western District of Louisiana

Shreveport Division

S. P. Davis, Sr., Plaintiff-Appellee

v.

United States of America,

Defendant-Appellant

Civil Action No. 06-0158

MEMORANDUM RULING

Before the Court is a Motion for Summary Judgment (Record Document 62) filed by the defendant and counterclaimant, the United States of America ("United States"). The United States seeks judgment as a matter of law that plaintiff and counterclaim defendant, S.P. Davis, Sr. ("Davis"), and four additional counterclaim defendants, Willie J. Singleton ("Singleton"), Phillip Pennywell, Jr. ("Pennywell), James C. Williams ("Williams"), and Samuel W. Stevens ("Stevens"), were persons responsible for the collection and payment of the employment taxes of three corporate entities and willfully failed to make the tax payments such that they are jointly and severally liable. Davis, Singleton, Pennywell, Williams, and Stevens ("the counterclaim defendants") opposed the motion. *See* Record Documents 72 & 74. For the reasons which

follow, the Motion for Summary Judgment is **GRANTED**.

FACTUAL BACKGROUND

Davis, Singleton, Pennywell, and Williams were equal 25% owners, officers of, and members of the board of Winward Institute, inc. ("Winward institute"), doing business as Winward Hospital, Winward Healthcare Center, Inc. ("Winward Healthcare"), and Mynex, Inc. ("Mynex") during the tax quarters at issues for each company from 1996 to 1998. *See* Record Document 62, Exhibits 22 at 3659-60; 28 at 4095-96; 29 at 4046-47; 57 at 5378; 72 at 13-14. Winward Institute was incorporated in 1995 in Louisiana and provided long-term acute care rehabilitative health services. *See id.*, Exhibit 44 at 1182; 1 at 1188. By the end of 1997, Winward Institute had expanded from one hospital in Shreveport to five facilities in Louisiana. *See id.*_ Its primary income sources were Medicare and Medicaid payments. *See id.*, Exhibit 44 at 1182. On March 25, 1998, Winward Institute's creditors filed an involuntary bankruptcy petition under Chapter 7 of the Bankruptcy Code. *See id.*, Exhibit 74 at 1, 3. The involuntary Chapter 7 proceeding was converted to a voluntary Chapter 11 proceeding on May 22, 1998. *See id.* at 4. Winward Institute applied to the Bankruptcy Court, and obtained authorization by order entered May 26, 1998, to operate as a debtor-in-possession. *See id.* at 4, 13-14. Winward Institute continued as a debtor-in-possession until a Chapter 11 trustee was appointed on July 21, 1998. *See id.* The bankruptcy was converted back to a Chapter 7 proceeding on November 3, 1998, and was terminated on June 26, 2006. *See id.* at 1, 22.

Winward Healthcare and Mynex were two related, but separately incorporated companies. *See id.*, Exhibits 70 at 167; 69 at 43-44; 22 at 3660. Winward Healthcare was incorporated in 1995. *See id.*, Exhibit 5. Mynex was incorporated in Louisiana in 1996. *See id.*, Exhibit 7 at 1194. Mynex provided management services, pharmaceutical services and product, transportation services, therapy services and marketing services to Winward Hospital and Winward Healthcare Clinic. An involuntary Chapter 7 bankruptcy petition was filed against Mynex on October 2, 1998. *See id.*, Exhibits 73 at 95; 75 at 1-2. A Chapter 7 trustee was appointed for Mynex on or about November 30, 1998. *See id.*, Exhibit 75 at 3.

At all relevant times, Stevens, a Certified Public Accountant ("CPA"), served as the Vice President of Finance. *See id.*, Exhibits 42, 57, 73. He was hired in early 1997 by Singleton to serve thereafter as the Vice President of Finance of the three companies. *See id.*, Exhibits 57, 73. Stevens reported to James Dan Reid ("Reid"), who served as the Senior Vice President and Chief Operating Officer. *See id.*, Exhibits 69, 70, 73. Reid resigned in late 1997[1] and Stevens began reporting directly to the Board. *See id.*

Each of the three companies maintained separate checking accounts. *See id.*, Exhibits 7-14. The owners had signature authority over the

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[1] After learning of the tax delinquencies, Davis sought to fire Reid. *See* Record Document 62, Exhibit 69 at 36-37. Davis was overruled by the majority of the Board and Reid was permitted to resign. *See id.*

corporate bank accounts of the companies. *See id.* The owners signed checks for all three companies. *See id.* The finance/corporate accounting department prepared the checks for the three companies and the owners supplied the signature. Typically, the accounting department would prepare the checks made payable to the creditors and two board members would routinely sign the checks. The owners personally invested hundreds of thousands of dollars during the lives of the companies, including initial investments and periodic capital infusions. *See id.*, Exhibits 69-72. All of the owners had the ability to recommend the firing of employees. *See id.*

The owners became aware of a federal tax lien in the fall of 1997 when a paralegal in Singleton's and Davis' office read of a tax lien related to one or more of the companies in a local legal publication. *See id.*, Exhibits 69, 70, 71, 72. The tax lien was approximately $1 million. Stevens became aware, sometime prior to September 1997, that the three companies were in arrears with their payroll taxes. The owners held a meeting, called by Singleton, after they became aware of the report of the tax lien and instructed Stevens to verify that taxes were due, contact the Internal Revenue Service ("IRS"), find out what actions were appropriate in order to have the taxes paid by the companies and report back to the owners. *See id.*, Exhibits 69, 70, 71, 72.

Singleton was the Chief Executive Officer, Chairman of the Board, and an owner of the three companies. *See id.*, Exhibits 6, 70. He was an attorney with an outside law practice during all relevant time periods. *See id.*, Exhibit 70. He contributed at least $300,000 to the companies

during the life of the businesses. *See id.* He was aware of operational plans and efforts to reduce costs and generate more cash flow in 1997. *See id.*

Davis, an attorney who also had a law practice and served as a Colonel in the United States Army Reserves, was a founder, owner, officer and director of, and provided legal counsel to, all three companies. *See id.*, Exhibit 69. He provided legal advice to hospital staff and administration, reviewed legal documents when requested to do so, and conducted medical malpractice prevention seminars at all Winward facilities. *See id.* He was aware of the corporate financial problems in 1997. *See id.*

Pennywell has a bachelors degree in psychology and a masters degree in education, both from Southern University, and has received a Ph.D. in psychological statistics from University of North Texas. *See id.*, Exhibit 71. He invested $250,000 in Winward Institute and Mynex. He served as vice president for human resources for the three companies. *See id.* He was aware of the financial problems of the companies in 1997, but did not participate in any negotiations with the IRS regarding the outstanding trust fund taxes. *See id.*

Williams earned his bachelor of science degree in chemistry from Southern University in 1971. *See id.*, Exhibit 72. He served as Treasurer of each of the three companies and assisted the therapy department by personally taking part in recruiting therapists, and interviewing them. He had approximately $300,000 invested in the companies. *See id.*

Mynex's management division performed the accounting functions, including payroll services and check writing functions, for all three of the businesses at issue. *See id.*, Exhibit 77. Stevens' department had financial reporting duties, including management reports, including preparation of financial statements, preparation of payroll tax returns and cost reports and weekly internal financial reports. *See id.*, Exhibits 72, 73, 77. His department also made bank deposits and produced payroll checks. *See id.* He never had any authority to sign any checks on behalf of any corporate entity. *See* Record Document 72, Exhibits 501, 502. He never owned any stock in any corporate entity at issue in these proceedings. *See* Record Document 72-2 at 2.

PROCEDURAL BACKGROUND

Davis, Singleton, Williams, Pennywell, and Stevens were assessed for the trust fund portion of payroll taxes withheld from the wages of employees of Winward Institute, Winward Healthcare, and Mynex. *See* Record Document 62, Exhibits 66, 68. The trust fund portion of payroll taxes withheld from the wages of the employees claimed by the IRS pertaining to the Winward institute are for the third quarter 1996; second quarter 1997; third quarter 1997; fourth quarter 1997; first quarter 1998; second quarter 1998. The trust fund taxes claimed by the IRS pertaining to Winward Healthcare are for the third quarter 1997; fourth quarter 1997; first quarter 1998; and second quarter 1998. The trust fund taxes claimed by the IRS pertaining to Mynex are for the first quarter 1997; second quarter 1997; third quarter 1997;

fourth quarter 1997; first quarter 1998; and second quarter 1998.

Davis, Singleton, Williams, and Pennywell ("the owners") were assessed by the IRS as persons responsible for trust fund tax payments for the three companies for the quarters described above. The owners dispute these assessments. Stevens was assessed by the IRS as a responsible person for the same tax periods as the owners, except for the third quarter of 1996. Stevens also disputes the assessments.

Davis utilized the divisible tax procedure, paid under protest the amounts assessed for one employee for one quarter for each company, and then filed a claim for refund. The claim for refund was denied. On January 27, 2006, Davis filed the instant suit to recover amounts he paid toward the aforementioned federal tax liabilities. The United States counterclaimed, and also filed suit against Singleton, Pennywell, Williams, and Stevens, for the full amounts assessed, plus interest and penalties. All of the counterclaim defendants deny liability for any amounts claimed by the IRS.

On June 30,2008, the United States filed a Motion for Summary Judgment, seeking a judgment imposing liability against the counterclaim defendants, specifically Davis in the mount of $3,152,862.85; Singleton in the amount of $3,152,757.49; Pennywell in the amount of $3,152,438.07; Williams in the amount of $3,152,757.77; and Stevens in the amount of $3,406,313.64. *See* Record Document 62. The United States acknowledged that under longstanding administrative practice, the total

amount of the unpaid taxes is collected only once. *See id.* at 4 n. 2.[2] The counterclaim defendants have opposed the Motion for Summary Judgment. See Record Documents 72 & 74.

LAW AND ANALYSIS

I. Summary Judgment Standard.

Summary judgment is proper pursuant to Rule 56 of the Federal Rules of Civil Procedure "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." *Celotex Corp. v. Catrett,* 477 U.S. 317, 322, 106 S. Ct. 2548, 2552 (1986). "Rule 56(c) mandates the entry of summary judgment, after adequate time for discovery and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." *Stahl v. Novartis Pharm. Corp.,* 283 F.3d 254, 263 (5th Cir. 2002). If the movant demonstrates the absence of a genuine issue of material fact, "the nonmovant must go beyond the pleadings and designate specific facts showing that there is a genuine issue for trial." *Littlefield v. Forney Indep. Sch. Dist.,* 268 F.3d 275, 282 (5th Cir. 2001). Where critical evidence is so weak or tenuous on an essential fact that it could not

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[2] Responsible persons who act willfully in failing to ensure the payment of taxes and are assessed under Section 6672 "are jointly and severally liable." *Mazo v. U.S.,* 591 F.2d 1151, 1157 (5th Cir. 1979).

support a judgment in favor of the nonmovant, then summary judgment should be granted. *See Alton v. Tex. A&M Univ.*, 168 F.3d 196, 199 (5th Cir. 1999).

II. Section 6672(a) Liability.

The Internal Revenue Code requires employers to withhold federal income tax and social security taxes from their employees' wages. *See Howard v. U.S.*, 711 F.2d 729,733 (5th Cir. 1983), citing 26 U.S.C. §§ 3102, 3402. The withholdings are held in a special trust fund for the United States. *See Howard*, 711 F.2d at 733. Each employee is considered to have paid the taxes to the United States even if their employer does not remit the funds to the Government. *See id.; Wood v. U.S.*, 808 F.2d 411, 414 (5th Cir. 1987). When a corporate employer neglects to pay the required taxes, Section 6672(a) of the Internal Revenue Code authorizes the Government to assess the full amount of taxes due against the corporation's responsible officers in the form of a penalty. *See Howard*. 711 F.2d at 733; 26 U.S.C. § 6672(a). Section 6672(a) provides, in pertinent part:

> Any person required to collect, truthfully account for, and pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty equal to the total amount of the tax evaded, or not collected, or not accounted for and paid over.

26 U.S.C. § 6672(a). Section 6672(a) imposes two specific requirements for liability: a "responsible person" who acted "willfully" in not paying the taxes. *See Wood*, 808 F.2d at 414.

A. Burden of Proof.

It is well settled in tax dispute cases that an assessment is entitled to a legal presumption of correctness. *See U.S. v. Fior D'Italia, Inc.*, 536 U.S. 238, 242, 122 S. Ct. 2117, 2122 (2002). The tax deficiency is presumptively correct under this rationale, unless there is a finding that the computational methods used, and therefore the assessment, were arbitrary and without foundation. *See Olster v. Comm'r of I.R.S.*, 751 F.2d 1168, 1174 (11th Cir. 1985). The taxpayer bears the burden of proving that the computational methods used were arbitrary and without foundation. *See id.*, citing *Mersel v. U.S.*, 420 F.2d 517 (5th Cir.1970). Thus, in Section 6672(a) cases, "once the Government offers an assessment into evidence, the burden of proof is on the taxpayer to disprove his responsible-person status or willfulness." *Barnett v. I.R.S.*, 988 F.2d 1449, 1453 (5th Cir. 1993).

Here, the United States has submitted certificates of assessments and payments regarding each of the counterclaim defendants' responsible person liabilities. *See* Record Document 62, Exhibits 68-1 through 68-35. These assessments are part of the summary judgment record. Notwithstanding, the counterclaim defendants challenge the correctness of the assessments made against them on two grounds: (1) a financing agreement with Daiwa Financial Services; and (2) IRS Case History Notes.

The counterclaim defendants argue that there can be no outstanding payroll tax liabilities for any time period prior to March or April 1997, the timeframe in which the three companies allegedly entered into a financing agreement with Daiwa. According to the counterclaim defendants, Daiwa required the three companies to pay their outstanding payroll tax obligations as a condition of its providing financing, and, because Daiwa ultimately provided financing, the taxes must have been paid. However, this argument is legally flawed, as the counterclaim defendants failed to submit a copy of the financing agreement as part of the summary judgment record. Their assertion, without more, is hearsay and not the competent summary judgment evidence needed to sustain their burden of proving that the computational methods used in this case were arbitrary and without foundation.

The counterclaim defendants also rely on narrow, selected excerpts from the IRS case history notes to defeat the legal presumption of correctness. First, they point to various case history notes relating to Winward Institute. The first notation states that the case was opened on December 7, 1996 and then another states that the case was closed on May 16, 1997. The counterclaim defendants argue that these notations conclusively prove that no tax liability existed for any of the three entities prior to March or April 1997. This argument appears to be somewhat of a legal stretch; its persuasiveness is further lessened by a subsequent notation that the case was reopened.

The counterclaim defendants also challenge the assessments based on other general history notations relating to Winward Institute and Mynex, specifically a May 2000 general history note stating:

> List of things to consider in investigation of this and related case Winward Healthcare and Mynex.
>
> 1. Resolve credit balances on TDI tax periods 01-09/30/1998 and 12/31/1998, for both Winward Institute and Mynex.

Record Document 74, Exhibit 259 at 0306. This notation is insufficient to rebut the legal presumption of correctness, as it appears to simply be part of a "to do list" to continue the investigation of the tax delinquencies of the three companies and there is no record evidence that there were, in fact, credit balances. Moreover, the IRS did not assess responsible person liabilities regarding Winward Institute's third and fourth quarters of 1998 and Mynex's fourth quarter of 1998. The counterclaim defendants further rely on other notations referencing mere recommendations and notes to the effect that one of the three companies was staying current with tax deposits. In the context of the case notes as a whole, these isolated notations simply do not establish that the IRS's computational methods were arbitrary and without foundation. Thus, the burden of disproving their responsible-person status and/or willfulness remains with the counterclaim defendants.

B. Responsible Person(s).

The Fifth Circuit generally takes a broad view of who qualifies as a responsible person under Section

6672(a). *See Barnett*, 988 F.2d at 1454. Responsibility is determined by one's status, duty, and authority. *See id.*; *Wood*, 808 F.2d at 415. Responsibility does not require knowledge that one has that duty and authority to withhold and pay taxes. *See Barnett*, 988 F.2d at 1454. "The crucial inquiry is whether the person had the 'effective power' to pay the taxes - that is, whether he had the actual authority or ability, in view of his status within the corporation, to pay the taxes owed." *Id.* In fact, a person may qualify as a responsible person even if he did not know that withholding taxes have not been paid. *See id.* Likewise, a person does not cease to be a responsible person merely by delegating the responsibility to others. *See id.* at 1454-1455. Section 6672(a) further extends to "any" responsible persons, not simply to the person most responsible for the payment of the taxes. *See id.* at 1455. Typically, there are multiple responsible persons in any company. *See id.* The ultimate determination "is whether a [person], by virtue of his position in . . . the company, could have had 'substantial' input into [withholding and paying employees' taxes and paying creditors], had he wished to exert his authority." *Id.*

In a case where a person lacks the precise responsibility of withholding or paying employees' taxes, the Fifth Circuit has looked to a number of circumstantial indicia of responsible person status. *See id.* These factors include whether the person:

(i) is an officer or member of the board of directors;

(ii) owns a substantial amount of stock in the company;

(iii) manages the day-to-day operations of the business;

(iv) has the authority to hire or fire employees;

(v) makes decisions as to the disbursement of funds and payment of creditors; and

(vi) possesses the authority to sign company checks.

Id. No single factor is dispositive of the issue. *See id.*

Singleton, Davis, Pennywell, and Williams were all founders, equal 25% owners, officers, and directors in each of the three companies during the periods the trust fund taxes were not fully paid. Singleton, a practicing attorney, was the Chief Executive Officer and Chairman of the Board. See Record Document 62, Exhibit 70 at 79. He attended weekly meetings with hospital management and was involved in corporate policy making. *See id.* at 49-53. He was also an active participant and organizer of meetings to address company problems. *See id.* at 147-149. Singleton testified in his deposition that he would receive the financial reports of the companies. *See id.* at 52-53. He was involved in the day-to-day operations of the companies, including hiring and firing of employees. *See* Record Document 62, Exhibit 77 at 4. Singleton visited a Winward facility every day and his law office was located in the same building as the Winward corporate offices. *See* Record Document 62, Exhibit 70 at 31. He had the authority to sign checks for all three companies and testified in his deposition that the accounting staff would routinely bring him checks to sign and that

whatever they brought to him, he would sign. *See id.* at 57-58. Singleton further testified that he had the authority to refuse to sign a check. *See id.* at 102.

Davis, also a practicing attorney, provided legal counsel to the three companies, specifically rendering legal guidance to staff and administration, reviewing legal documents, and conducting medical malpractice prevention seminars at all facilities. *See* Record Document 62, Exhibit 69 at 47-48. Davis testified in his deposition that he was involved in personnel issues and, as a member of the Board, had the ability to recommend the firing of employees. *See id.* at 36-37, 48. He further testified that he considered himself to be a "very active" participant in the companies, visiting the Winward facilities at least three times a week and attending the weekly meetings with staff and other board members. *See id.* at 50, 52,136. Davis had the authority to deal with major suppliers and customers; negotiate corporate contracts and loans; open and close corporate bank accounts; sign/countersign corporate checks; and guarantee/co-sign corporate bank loans. *See* Record Document 62, Exhibit 39 at 0179. He was also authorized to sign on all checking accounts for the three companies and routinely signed the checks presented to him by the accounting department. *See* Record Document 62, Exhibits 7-9, 69 at 38.

Pennywell, who holds a Ph.D. in psychology, served as Senior Vice President for Human Resources for the three companies. *See* Record Document 62, Exhibits 6 at 0633, 71 at 7. He had the authority to deal with major suppliers and

customers; negotiate corporate contracts and loans; open and close corporate bank accounts; sign/countersign corporate checks; and guarantee/co-sign corporate bank loans. *See* Record Document 62, Exhibit 37 at 1503. Pennywell testified in his deposition that he tried to attend the weekly meetings with staff and other board members. *See* Record Document 62, Exhibit 71 at 29-29. He further testified that he worked closely with the human resources staff, addressed concerns in the benefits and patient relations areas, spent time with patients to monitor patient care, helped to ensure compliance with personnel policies, and worked with community relations. *See id.* at 14-15, 21-22, 66. He could and did sign checks for all three companies, but stated that he never refused to sign a check. *See id.* at 24, 28.

Williams served as Senior Vice President and Treasurer of each of the companies. See Record Document 62, Exhibits 6 at 0633, 72 at 13-14. As a board member, he had the authority to sign checks on behalf of the three companies and was authorized to sign checks on all checking accounts held by the three companies. *See* Record Document 62, Exhibit 72 at 26, 90-91. Williams testified in his deposition that approximately once or twice a week, he attended meetings with some combination of the board members to discuss facility business. *See* Record Document 62, Exhibit 72 at 28-29. He also testified that he was involved in the day-to-day business of the companies. *See id.* at 42-44. He was active in recruiting therapists, monitored the therapy department, and addressed any concerns raised in the therapy department. *See id.* at 12-13,18, 33-34, 42-44. As

a board member, Williams also had the authority to hire and fire employees. *See id.* at 47-48. Williams also had the authority to manage employees; sign/countersign corporate checks; guarantee/co-sign corporate bank loans; and authorize payroll checks. *See* Record Document 62, Exhibit 28 at 4097.

None of the owners can dispute that he was an officer, board member, and equal shareholder of each of the three companies during the relevant time periods. The owners also can not contest that they had the authority to, and did, sign checks on behalf of all of the companies. They were each intimately involved in running the companies. However, the owners seem to contend that because they hired others to run the businesses' financial department, they can not be held responsible for the failure to pay the withholding taxes at issue. This argument fails, as there is no dispute that their sweeping authority over the businesses extended to financial matters, regardless of whether they exercised that authority and/or hired individuals, such as Reid and Stevens, to oversee the financial department.

This Court must consider whether the owners, by virtue of their positions in the companies, could have had substantial input into decisions relating to the payment of payroll taxes, had they wished to exert their authority. *See Barnett*, 988 F.2d at 1455. The summary judgment record establishes that they could have exercised control over the businesses' finances, including the payment of payroll taxes, anytime they wanted. They had the authority to, and did, sign all of the checks for the three companies. Regardless of whether Reid or Stevens prepared the checks, there is no record

evidence indicating that any two owners could not have written a check to pay a creditor or simply instructed Reid or Stevens to do so. Further, the owners' argument that, after they learned of the payroll tax deficiencies, they told Stevens to take the appropriate steps to rectify the situation also fails. The delegation to another of the authority to see that payroll taxes are paid does not allow a responsible person to escape liability under Section 6672(a). *See Mazo*, 591 F.2d at 1155. Based on the foregoing, the Court finds, as a matter of law, that Singleton, Davis, Pennywell, and Williams are all persons responsible for collecting, truthfully accounting for, and paying over the payroll taxes in question. The Court will now consider whether Stevens is also a responsible person under Section 6672(a).

Stevens argues that he was not a responsible person for purposes of Section 6672(a). First, he maintains that he never owned stock in any of the three corporate entities and he could not sign company checks or effect bank transactions. *See* Record Document 72-3 at 4. He further contends that he could not make any decisions as to the disbursement of funds, the prioritization of disbursements, or the payment of creditors. *See id.* at 6. Stevens also asserts that he could not fire employees and that his ability to hire extended only to the accounting manager and his secretary. *See id.* Stevens appears to argue that he was not a responsible person because Reid, who was his superior, was the individual in charge of all of the operations of the corporate entities. *See id.* at 8.

Even accepting all of Stevens' arguments as true, the Court finds the he was a responsible

person for purposes of Section 6672(a). Stevens was formally hired by Mynex, but served as Vice President of Finance for all three companies. There is no dispute that Stevens supervised the accounting department, oversaw the preparation of all checks, prepared and signed quarterly employment tax returns on behalf of all three companies, and acted as the corporate representative to outside CPAs, Medicare, and the IRS. The preparation of checks extended to all financial obligations, including payroll and any checks to pay federal tax deposits. The key issue is whether Stevens, by virtue of his position, could have had substantial input into decisions relating to the payment of the trust fund taxes and the payment of other creditors, had he wished to exert his authority. *See Barnett*, 988 F.2d at 1455. Here, undisputed evidence establishes that the owners signed all checks presented to them. Stevens could have easily directed the accounting department to draft checks to the IRS instead of other creditors. Stevens' argument that he had no power to fire and that his hiring ability was limited to the selection of an accounting manager and his secretary does not conflict with his qualification as a responsible person, as limited hiring ability does not relieve him of his responsibility to make certain that the trust fund taxes were being paid. *See Frey v. U.S.*, No. 99-0831, 2001 WL 493136, *4 (N.D.Tex. May 4, 2001) (reasoning that evidence relating to the authority to hire and fire employees and to participate in such decisions does not create a genuine issue of material fact on the issue of whether an individual is a responsible person). The *Frey* court also noted that "authority to make employment decisions within the accounting

department, even if not unilateral, would only permit a reasonable trier of fact to find that she did exercise significant control over [the company's] operations." *Id.* The Court finds, as a matter of law, that Stevens was a person responsible for collecting, truthfully accounting for, and paying over the payroll taxes in question.

C. Willfulness.

Because Section 6672(a) imposes liability on a responsible person only if that person "willfully" failed to collect, account for, or pay over withheld taxes, the willfulness inquiry is often the sifter in Section 6672 cases. *See id.* at 1457. In the context of Section 6672(a), willfulness does not require a bad motive or evil intent, but merely a voluntary, conscious, and intentional act. *See Wood.* 808 F.2d at 415. citing *Mazo v. U.S.*, 591 F.2d 1151, 1154 (5th Cir. 1979). In *Mazo,* the Fifth Circuit acknowledged that the willfulness inquiry "is necessarily directed to the state of the responsible person's mind, a subjective determination" that is usually factual and may preclude summary judgment. Mazo, 591 F.2d at 1157. Yet, the court concluded that "evidence that the responsible person had knowledge of payments to other creditors after he was aware of the failure to pay withholding tax is sufficient for summary judgment on the question of willfulness." *Id.* Further, a responsible person acts willfully when he proceeds with reckless disregard of known or obvious risks that trust funds may not be remitted to the government. *See Wood,* 808 F.2d at 415; *Mazo,* 591 F.2d at 1155. Examples of such reckless disregard include "failing to investigate or to correct mismanagement after being notified that

withholding taxes have not been duly remitted." *Mazo,* 591 F.2d at 1155.

Singleton, Davis, Pennywell, and Williams contend that they did not act willfully because after learning of the tax liabilities in the fall of 1997, they took all reasonable efforts to see that the taxes were paid. They contend that they established a system of checks and balances as to Stevens' actions; called an emergency board meeting in November 1997; and instructed Reid and Stevens to undertake a course of action to ensure the timely payment of all employee tax obligations. Stevens was specifically instructed to contact the IRS and, according to the owners, he later reported back to them that he had worked out an installment agreement with the IRS and the IRS would allow the three entities to continue to operate. The owners also contend that Stevens was directed to pay the IRS in preference to any other creditor.

Even if the Court assumes that Stevens assured the owners that he was taking care of the outstanding taxes, they can not avoid liability. In *Mazo,* the Fifth Circuit reasoned:

> In essence the appellants' primary argument is that an issue was created with respect to willfulness by their contention that Lavoie, the controller, misled them by asserting that he had taken care of the matter or would take care of the matter for them. However, once they were aware of the liability to the government, they were under a duty to ensure that the taxes were paid before any payments were made to other creditors. If, after receiving actual notice, corporate officials could once again

> delegate their responsibility to subordinates, then repeated escape from liability would be possible and the government would be required to monitor corporate affairs daily. The statutory concept of willfulness conveys no such meaning.

Mazo, 591 F.2d at 1157. Here, the owners became aware of the tax liability in the fall of 1997. Yet, even after this date, the three companies continued to make payroll and make at least partial payments to other creditors while the delinquent taxes were accruing. *See* Record Document 62, Exhibits 28 at 4100, 29 at 4051, 30 at 0128. When presented with company checks to sign, the owners did not scrutinize the checks and ensure that federal tax deposit checks were being signed in preference to payroll and checks to other creditors. At a minimum, the owners exhibited reckless disregard in failing to investigate and ensure that Stevens was, in fact, handling the tax delinquencies.

The owners also argue that a finding of willfulness is precluded because they had no ability to pay Winward Institute's withholding tax obligations after its involuntary bankruptcy proceeding was instituted in March 1998. In May 1998, the Bankruptcy Court approved Winward Institute's application to operate as a debtor-in-possession, which continued until July 21, 1998, when a Chapter 11 trustee was appointed. Yet, on June 26, 1998, prior to the appointment of a trustee, Winward Institute moved the Bankruptcy Court for authority to compensate Stevens. This filing negates the owners' contention that the filing of the bankruptcy stripped them of control and

authority, as no trustee was in place and Winward Institute could not have been running itself at this time. At this point, the owners could have petitioned the Bankruptcy Court for specific approval to pay the taxes due in lieu of seeking permission to compensate Stevens. Thus, the owners remained responsible and willfully failed to pay Winward Institute's withholding taxes, despite the bankruptcy.[3]

The owners also argue that the three businesses had insufficient funds to pay the withholding taxes by the time they learned of the deficiencies. This argument fails as a matter of law. It is uncontested that the financial/accounting department continued to prepare checks for other creditors and that the owners continued to sign such checks after all of the counterclaim defendants knew about the tax deficiencies. The three businesses also continued to make payroll during the periods in which the withholding taxes were accruing. If there were

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[3] Such finding is supported by *Cook v. U.S.*, 52 Fed. Ct. 62 (Fed. Cl. 2002), which provided persuasive guidance to the Court. In *Cook,* a controlling shareholder and president of a business qualified as a responsible person. *See id.* In light of the business' bankruptcy, he challenged the willfulness requirement, arguing that bankruptcy judge effectively compelled him not to pay any other expenses including the company's trust fund tax obligations. *See id.* at 71. The court disagreed, reasoning "while the bankruptcy court, on several occasions, acceded to requests made by [the responsible person] to authorize particular expenditures . . . neither [the responsible person] nor his attorneys, during formal hearings or informal conferences . . . sought . . . leave to make those payments." *Id.* at 71-72.

funds available to pay other creditors and payroll, then there were unencumbered funds available to pay the tax obligations to the IRS.

Based on the foregoing analysis, the summary judgment record establishes that the owners, Singleton, Davis, Pennywell, and Williams, willfully failed to pay the three businesses' withholding tax obligations as a matter of law. The Court will now consider whether Stevens willfully failed to pay the withholding tax obligations.

Stevens argues that he did not act willfully because once he discovered the tax delinquencies in the fall of 1997, he immediately reported them to Reid, his supervisor. *See* Record Document 72-3 at 12. Stevens contends that he had no way of knowing whether Reid followed up on the tax delinquencies. *See id.* Further, he asserts that he followed the Board's directions and contacted the IRS to work out an installment plan. *See id.* He maintains that his reliance on this plan precludes a finding of willfulness. *See Id.*

The Court disagrees. Stevens has failed to present a copy of any alleged installment agreement. Further, even if there was an installment agreement, the existence of such an agreement would not preclude the Government from pursuing its rights under Section 6672(a). *See Looney v. U.S.*, 544 F.Supp.2d 574, 581 (S.D.Tex. 2008), citing *Cash v. U.S.*, 961 F.2d 562, 565 (5th Cir. 1992) ("Under well established law, the liability of a responsible person under § 6672 is independent of the

corporation's duty to pay trust fund taxes.").[4] Moreover, Stevens has failed to come forward with competent summary judgment evidence disputing the fact that he supervised the preparation of checks after he knew the trust fund taxes were not being paid. He also knew that each of the owners were continuing to sign checks made payable to other creditors after they knew the trust fund taxes were not being paid. Willfulness is established, as Stevens, a responsible person, had knowledge of payments to other creditors after he was aware of the failure to pay the trust fund taxes. *See Mazo*, 591 F.2d at 1157.

CONCLUSION

Based on the foregoing analysis, the Motion for Summary Judgment (Record Document 62) filed by the United States is GRANTED. Accordingly, Davis' complaint is **DISMISSED WITH PREJUDICE** and, pursuant to Section 6672, the counterclaim defendants are jointly and severally indebted to the United States as follows: Davis in the amount of $3,152,652.85; Singleton in the amount of $3,152,757.49; Pennywell in the amount of $3,152,438.07; Williams in the amount of $3,152,757.77; Stevens in the amount of $3,406,313.64. The counterclaim defendants are also jointly and severally liable for further interest and

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[4] The other counterclaim defendants similarly argued that a finding of willfulness was precluded due to the purported installment agreement. Yet, none of the counterclaim defendants presented a copy of any alleged installment agreement and seem to rely exclusively on IRS history notes that indicate that the IRS was simply considering a proposed installment agreement.

statutory additions as provided by law from June 30, 2008.

A judgment consistent with the terms of the instant Memorandum Ruling shall issue herewith.

THUS DONE AND SIGNED, in Shreveport, Louisiana, this 7th day of October, 2010.

S. MAURICE HICKS, JR.

UNITED STATES DISTRICT JUDGE

APPENDIX C

United States District Court

Western District of Louisiana

Shreveport Division

S. P. Davis, Sr., Plaintiff-Appellee

v.

United States of America,

Defendant-Appellant

Civil Action No. 06-0158

JUDGMENT

Based on the foregoing Memorandum Ruling,

IT IS ORDERED that the Motion for Summary Judgment (Record Document 62) filed by the defendant and counterclaimant, the United States of America, be and is hereby **GRANTED**.

IT IS FURTHER ORDERED that the complaint of plaintiff S.P. Davis, Sr., against the United States of America is **DISMISSED WITH PREJUDICE**.

IT IS FURTHER ORDERED that plaintiff and counterclaim defendant S.P. Davis, Sr., is indebted to the United States in the amount of $3,152,652.85 for federal tax liability pursuant to Title 26, United States Code, Sections 6671 and 6672 as of June 30, 2008, for the third quarter of 1996; all four calendar quarters of 1997; and the first, second and third quarters of 1998; plus further interest and statutory additions as provided by law from June 30, 2008.

IT IS FURTHER ORDERED that counterclaim defendant Willie J. Singleton is indebted to the United States in the amount of $3,152,757.49 for federal tax liability pursuant to Title 26, United States Code, Sections 6671 and 6672 as of June 30, 2008, for the third quarter of 1996; all four calendar quarters of 1997; and the first, second and third quarters of 1998; plus further interest and statutory additions as provided by law from June 30, 2008.

IT IS FURTHER ORDERED that counterclaim defendant Phillip Pennywell, Jr., is indebted to the United States in the amount of $3,152,438.07 for federal tax liability pursuant to Title 26, United States Code, Sections 6671 and 6672 as of June 30, 2008, for the third quarter of 1996; all four calendar quarters of 1997; and the first, second and third quarters of 1998; plus further interest and statutory additions as provided by law from June 30, 2008.

IT IS FURTHER ORDERED that counterclaim defendant James C. Williams is indebted to the United States in the amount of $3,152,757.77 for federal tax liability pursuant to Title 26, United States Code, Sections 6671 and 6672 as of June 30, 2008, for the third quarter of 1996; all four calendar quarters of 1997; and the first, second and third quarters of 1998; plus further interest and statutory additions as provided by law from June 30, 2008.

IT IS FURTHER ORDERED that counterclaim defendant Samuel W. Stevens, III, is indebted to the United States in the amount of $3,406,313.64 for federal tax liability pursuant to

Title 26, United States Code, Sections 6671 and 6672 as of June 30, 2008, for all four calendar quarters of 1997; and the first, second and third quarters of 1998; plus further interest and statutory additions as provided by law from June 30, 2008.

IT IS FURTHER ORDERED that S.P. Davis, Sr., Willie J. Singleton, Phillip Pennywell, Jr., James C. Williams, and Samuel W. Stevens, III, are jointly and severally liable for the aforementioned indebtedness, including interest and statutory additions as provided by law.

The Clerk of Court is directed to close this case.

THUS DONE AND SIGNED, in Shreveport, Louisiana, this 7th day of October, 2008.

S. MAURICE HICKS, JR.

UNITED STATES DISTRICT JUDGE

APPENDIX D

United States District Court
Western District of Louisiana
Shreveport Division

S. P. Davis, Sr., Plaintiff-Appellee

v.

United States of America,
Defendant-Appellant

Civil Action No. 06-0158

MEMORANDUM ORDER

Before the Court are three motions: Motion for Reconsideration and for New Trial (Record Document 97) filed by plaintiff and counterclaim defendant S.P. Davis, Sr. ("Davis") and counterclaim defendants Willie J. Singleton ("Singleton"), Phillip Pennywell, Jr. ("Pennywell"), and James C. Williams ("Williams"); Motion for Reconsideration and New Trial (Record Document 98) filed by counterclaim defendant Samuel Stevens ("Stevens"); and Rule 52(b) Motion for Amended or Additional Findings and for Stay of Execution of Judgment (Record Document 99) filed by Stevens. The United States of America ("United States") opposed all of the motions. *See* Record Documents 102 & 103. For the reasons which follow, the motions are **DENIED.**

The factual and procedural background of this case have been set forth fully in the Court's

Memorandum Ruling of October 7, 2008 (Record Document 95) and in the briefs submitted in connection with the instant motions. Thus, the facts and procedure bear no repeating and the Court will move to the merits of the motions.

Motion for Reconsideration and for New Trial filed by Davis, Singleton, Pennywell, and Williams

Pursuant to Federal Rule of Civil Procedure 59, Davis, Singleton, Pennywell, and Williams ("the Davis group") argue that they are entitled to an amended judgment and a new trial in order to correct a clear legal error and to prevent a manifest injustice. Specifically, the Davis group contends that the Court, in granting the United States' Motion for Summary Judgment, "committed a legal error . . . when instead of determining if there were material facts at issue warranting a trial, it chose to weigh the relevant evidence offered by each party." Record Document 97-3 at 8.

The Court first notes the stringent legal standard associated with Rule 59 motions, namely that such motions are extraordinary remedies that should be used sparingly. *See Templet v. HydroChem Inc.*, 367 F.3d 473, 479 (5th Cir. 2004). Moreover, after reviewing its prior ruling and the briefs filed in connection with the instant motion, the Court concludes that it did not improperly weigh the summary judgment evidence. Rather, the Court concluded that the summary judgment evidence offered by the Davis group was legally insufficient, on a number of grounds, to defeat summary judgment. The Motion for Reconsideration and for

New Trial filed by the Davis group is, therefore, denied.

Motion for Reconsideration and New Trial and Rule 52(b) Motion for Amended or Additional Findings and for Stay of Execution of Judgment filed by Stevens

Stevens adopts all of the arguments set forth in the Davis group's motion, but further argues that the Court improperly made credibility determinations and weighed evidence, namely on the issue of willfulness. *See* Record Document 98-2 at ii. Again, the Court finds that it engaged in no improper weighing of the evidence and/or credibility determinations. Instead, it determined that Stevens' summary judgment evidence was legally insufficient to create a genuine issue of material fact.

Stevens also contends in both motions that the United States never addressed his counterclaim, which dealt with the benefits of an alleged compromise and settlement agreement, in its Motion for Summary Judgment. Thus, he argues that he is entitled to both a new trial and additional findings on this issue. As noted by the United States, Stevens did not address his counterclaim in his opposition to the Motion for Summary Judgment. Rule 59(e) allows a party to correct manifest errors of law or fact or to present newly discovered evidence. *See Templet*, 367 F.3d at 479. The rule is not meant to permit Stevens to present new evidence regarding his affirmative defense, as such evidence was previously available and should have been presented in opposition to the United

States' Motion for Summary Judgment.[1] Under this same rationale, the Court declines to make additional findings as to Stevens' counterclaim. Therefore, the Motion for Reconsideration and New Trial and the Rule 52(b) Motion for Amended or Additional Findings and for Stay of Execution of Judgment are both denied.

Accordingly,

IT IS ORDERED that the Motion for Reconsideration and for New Trial (Record Document 97) filed by plaintiff and counterclaim defendant S.P. Davis, Sr. and counterclaim defendants Willie J. Singleton, Phillip Pennywell, Jr., and James C. Williams be and is hereby **DENIED.**

IT IS FURTHER ORDERED that the Motion for Reconsideration and New Trial (Record Document 98) filed by counterclaim defendant Samuel Stevens be and is hereby **DENIED.**

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[1] The Fifth Circuit has rejected the assumption "that the entire record in the case must be searched and found bereft of a genuine issue of material fact before summary judgment may be properly entered." *Savers Federal Sav. & Loan Ass'n v. Reetz*, 888 F.2d 1497, 1501 (5th Cir. 1989). Rather, Rule 56(e) requires the nonmoving party to designate specific facts showing that there is a genuine issue for trial. *See id.* In fact, the Fifth Circuit has "specifically refused to overturn a summary judgment on a theory not advanced in opposition to the motion in the district court." *Id.*; *see also Batterton v. Tex. General Land Office*, 783 F.2d 1220, 1225 (5th Cir. 1986) (affirming district court's denial of a motion for reconsideration on a pleaded claim that the party failed to argue and support in opposition to summary judgment).

IT IS FURTHER ORDERED that the Rule 52(b) Motion for Amended or Additional Findings and for Stay of Execution of Judgment (Record Document 99) filed by counterclaim defendant Samuel Stevens be and is hereby **DENIED.**

THUS DONE AND SIGNED, in Shreveport, Louisiana, this 17th day of April, 2009.

S. MAURICE HICKS, JR.
UNITED STATES DISTRICT JUDGE

APPENDIX E

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 09-30392

[DATE FILED 1/27/2011]

S. P. DAVIS, SR

Plaintiff-Counter Defendant - Appellant

v.

UNITED STATES OF AMERICA,

Defendant-Counter Claimant - Appellee

v.

WILLIE J. SINGLETON; PHILLIP PENNYWELL, JR.; JAMES C. WILLIAMS; SAMUEL W. STEVENS. III,

Counter Defendants - Appellants

Appeal from the United States District Court for the Western District of Louisiana, Shreveport

ON PETITION FOR REHEARING

Before REAVLEY, PRADO, and OWEN, Circuit

Judges.

PER CURIAM:

IT IS ORDERED that the petition for rehearing is DENIED.

ENTERED FOR THE COURT:

/s/ Priscilla A. Owen
United States Circuit Judge
REHG2

APPENDIX F

[GRAPHICS OMITTED]

2010 Annual Report to Congress

NATIONAL TAXPAYER ADVOCATE

2010 ANNUAL REPORT TO CONGRESS

Volume One

Taxpayer Advocate Service

Your Voice at the IRS

December 31, 2010

[Header and Footer Graphics and Information Omitted]

MSP #6

IRS Collection Policies and Procedures Fail to Adequately Protect Taxpayers Suffering an Economic Hardship

RESPONSIBLE OFFICIALS

Richard E. Byrd Jr., Commissioner, Wage and Investment Division
Chris Wagner, Commissioner, Small Business/Self-Employed Division
Diane Ryan, Chief, Appeals

DEFINITION OF PROBLEM

In her 2008 Annual Report to Congress, the National Taxpayer Advocate urged the IRS to reconsider its longstanding collection enforcement policies and procedures, and recommended the IRS exercise more flexibility in dealing with taxpayers experiencing economic difficulties.[1] Last year, in *Vinatieri v. Commissioner*, the Tax Court held that the IRS abused its discretion by proposing to levy on a taxpayer who had shown that she was in economic

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[1] *See* National Taxpayer Advocate 2008 Annual Report to Congress 15-38 (Most Serious Problem: *The IRS Needs to More Fully Consider the Impact of Collection Enforcement Actions on Taxpayers Experiencing Economic Difficulties*].

hardship.[2] The error arose because the IRS interpreted the Internal Revenue Manual (IRM) as preventing it from placing the taxpayer's account into currently not collectible (CNC) status due to unfiled returns.[3]

More than a year has passed since *Vinatieri* was decided, yet IRS guidance still does not adequately explain procedures for placing an account with unfiled returns into CNC status rather than proceeding with a levy. To date, the IRS has not revised IRM sections that lead it to propose to levy on a taxpayer in economic hardship. Moreover, the IRS lacks sufficient procedures to monitor economic hardship among taxpayers. For example, the 136-page Appeals Quality Management System (AQMS) Reviewer's Guide, which provides guidance to Appeals employees on how to evaluate the quality of case dispositions, does not contain the word "hardship."[4] TAS continues to see cases involving

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[2] 133 T.C. No. 16 (Dec. 21, 2009), discussed *infra*.

[3] The National Taxpayer Advocate issued guidance to TAS employees explaining the Tax Court's decision and how to advocate for taxpayers who are facing IRS levies even though they are in economic hardship. TAS Interim Guidance Memorandum (IGM), *Interim Guidance on Handling Collection Cases Where Economic Hardship Is Present but the Taxpayer Has Not Filed All Required Returns* (Mar. 23, 2010), *available at* http://www.irs.gov/pub/foia/ig/tas/tas-13_1-0110-01.pdf.

[4] The Appeals Quality Management System (AQMS) Reviewer's Guide in Collection Cases (Rev. Dec. 31, 2009), *available at*

situations similar to *Vinatieri*, some of which required Taxpayer Assistance Orders to resolve.

ANALYSIS OF PROBLEM

Background

IRC § 6343(a)(1)(D) states that a levy shall be released if "the Secretary has determined that such levy is creating an economic hardship due to the financial condition of the taxpayer."

Treasury Regulation § 301.6343-1(b)(4) provides that economic hardship is present "if satisfaction of the levy in whole or in part will cause an individual taxpayer to be unable to pay his or her reasonable basic living expenses."[5] To determine if economic

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http://appeals.web.irs.gov/aqms/Documents/Collection_Reviewers_Guide.pdf.

[5] The IRS makes economic hardship determinations in a variety of other contexts. IRM 5.1.12.20 (May 29, 2008) permits IRS employees to issue manual refunds if the taxpayer is in economic hardship; IRM 5.8.11.2.1 (Sept. 23, 2008) permits IRS employees to consider an effective tax administration offer in compromise where the taxpayer's liability could be collected in full but collection would create an economic hardship, and IRM 5.16.1.1 (June 29, 2010) permits IRS employees to remove accounts from active inventory and report them as currently not collectible (CNC) where collection of the liability would create a hardship for the taxpayers by leaving them unable to meet necessary living expenses. In addition, a taxpayer may raise as a defense the inability to pay due to hardship in a hearing under IRC § 6330 as a "challenge to the appropriateness of collection action." *See* IRC

hardship is present, IRS compliance employees consider a number of factors such as the taxpayer's general earning potential, basic living expenses, and the cost of living in the taxpayer's geographic location.[6]

Existing Guidance May Lead to Inappropriate Levy Action.

In *Vinatieri*,[7] where the taxpayer, who had unfiled returns, established that she was in economic hardship, the Tax Court held that the IRS's proposed levy was not appropriate given that under IRC § 6343(a)(1)(D), the IRS must release a levy if economic hardship is present. Proceeding with a levy that would have to be immediately released constituted an abuse of discretion.

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§ 6330(c)(2)(ii); IRM 8.22.2.4.2 (Mar. 11, 2009).

[6] IRM 5.19.4.4.10(4)(j) (Mar. 8, 2010), based on IRC § 6343 and Treasury Regulation § 301.6343-1(b)(4)(ii). Specific factors include the taxpayer's age, employment status, employment history, future income earning ability, number of dependents, and status as someone else's dependent; the amount reasonably necessary for food, clothing, housing, medical expenses, current tax payments, court ordered payments, and expenses necessary to the taxpayer's production of income; the amount of property exempt from levy and available to pay the taxpayer's ordinary and necessary expenses; extraordinary circumstances; and other factors the taxpayer brings to the attention of the IRS that show an economic hardship.

[7] 133 T.C. No. 16 (Dec. 21, 2009).

The IRM provision the IRS considered in *Vinatieri* states:

> A compliance check will be made and the results documented in the case history for all hardship determinations per IRM 5.16.1.1(5). Any open filing requirements or Taxpayer Delinquency Investigation (TDI) modules [*i.e.*, years for which the taxpayer has not filed a return] must *be resolved* and *closed appropriately* when reporting an account currently not collectible under hardship provisions.[8]

The Appeals settlement officer interpreted this provision to mean that unfiled returns must be secured as a prerequisite for placing an account into CNC status because of the taxpayer's economic hardship. Other provisions in the IRM describe conditions under which an account may be "resolved" or "closed appropriately" without securing unfiled returns, but none of them include economic hardship as an overriding condition that

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[8] IRM 5.16.1.2.9(8) (Dec. 1, 2006) (emphasis added), as in effect when the IRS proposed to levy on the taxpayer in *Vinatieri*. The provision was revised in May 2009 and in June 2010. The only relevant change was to insert "generally." Such modules must now "generally" be resolved and closed appropriately when reporting an account CNC. As in the 2006 version, no guidance or cross reference explains how this "general" rule applies.

must be taken into account when the IRS is contemplating a levy.[9]

The IRM provision the IRS relied on in *Vinatieri* is not the only one that leads to the erroneous conclusion that an account with unfiled returns cannot be placed into CNC status. Similar provisions include:

- **IRM 5.1.7.7.3(5)** -- "Caution: Do NOT report any cases as CNC (hardship) until all

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[9] *See e.g.*, IRM 1.2.14.1.18 (Aug. 4, 2006), Policy Statement P-5-133 (where reference to factors ensuring compliance and evenhanded administration of staffing and other Service resources would not require enforcement of delinquency procedures); IRM 5.1.11.7.3 (June 2, 2004) (where it can be substantiated that the taxpayer has no filing requirement for a given year); IRM 5.1.11.6.1(4) (Jan. 15, 2010) (where the delinquent module is six years or older); IRM 5.1.11.6.1(8) (Jan. 15, 2010) (where the delinquent module is less than six years old, but it is clear from information available that the non-filer does not have or will not have the ability to pay some if not all of the potential tax liability over the ten-year statutory collection period). Additionally, when a taxpayer fails to file a timely return, IRC § 6020(b) authorizes the IRS to make a return, referred to as a substitute for return (SFR), based on information reported to the IRS. An SFR is sufficient to close a delinquent tax module. IRM 5.18.1.3 (Oct. 1, 2005); IRM 5.18.1.3.4 (Jan. 25, 2008). Moreover, the *Vinatieri* case might not have reached Appeals if all IRS employees had the same authority to close accounts with unfiled returns. Automated Collection System (ACS) employees must refer to IRM 5.19 for all case actions; they are not authorized to proceed according to the Collection Field function (CFf) portion of the IRM, *i.e.*, IRM 5.1.11.

delinquent returns are filed and the cause of the delinquency addressed."[10]

- **IRM 5.16.1.1(6)** – "All open filing requirements or Delinquent Return (Del RET) modules must generally be resolved and closed appropriately when reporting an account CNC."[11]

- **IRM 5.19.1.3.4.1(6)** – "Installment agreements and CNC hardships cannot be established if a return is required to be filed."[12]

- **IRM 5.19.1.7.1(6)** – "Accounts with both a return delinquency and balance due that may

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[10] Where unfiled returns (referenced in various IRM provisions) not only prevent the account from being placed into CNC status, but also lead the IRS to levy or propose to levy, the IRS will have abused its discretion under *Vinatieri*.

[11] This provision is very similar to the one relied on by the Appeals settlement officer in *Vinatieri*, and leads to the same erroneous conclusion that returns must be secured as a prerequisite to placing an account in CNC status. As in *Vinatieri*, this conclusion may in turn lead the IRS to levy or propose to levy despite the taxpayer's economic hardship, which would constitute an abuse of discretion.

[12] Reliance on this provision would exemplify the error the Appeals settlement officer made in *Vinatieri* because it leads to the conclusion that returns must be secured before CNC status is allowable, which in turn may lead the IRS to abuse its discretion by levying or proposing to levy despite the taxpayer's economic hardship.

qualify for a CNC hardship consideration, but have an open TDI module, a.k.a. Del Ret module, and the taxpayer refuses to file the delinquent returns, must be sent to QUEUE as unresolved. Before transferring to the QUEUE, *all levy sources MUST be exhausted* and a lien filed if appropriate (emphasis added).... Do not refer the TDI for Automated Substitute for Return (ASFR) processing or close the Taxpayer Delinquent Accounts (TDA s) as CNC hardship."[13]

- **IRM 5.19.1.7.1(8)** – "Do not report any cases as CNC (hardship) until all delinquent returns are filed. Discuss options with the taxpayer to address and avoid future liabilities, such as increase withholding, etc. *Enforce collection action* if the taxpayer refuses to clearly correct the cause of the delinquency unless there would be no balance due on delinquent or future tax periods" (emphasis added).[14]

- **IRM 5.19.18.5(4)** – "If the taxpayer is unable to pay, report the case Currently Not Collectible (CNC) using the unable to pay closing code. Caution: Do NOT report any cases as CNC (hardship) until all delinquent returns

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[13] Imposing a levy in reliance on the penultimate sentence of this IRM would constitute an abuse of discretion, under *Vinatieri*.

[14] Imposing a levy in reliance on the last sentence of this IRM would constitute an abuse of discretion, under *Vinatieri*.

are filed and the cause of the delinquency addressed."[15]

IRS employees would benefit from additional training on the principles outlined in the *Vinatieri* decision – independently of any other circumstance, the IRS should not levy or propose to levy if the levy will cause economic hardship. Any such levy will be *required* to be released immediately; thus, proposing or placing a levy that must be released immediately constitutes an abuse of discretion. Because of the potential for grievous harm, in addition to training on this issue, the IRM should provide that economic hardship *alone* is a sufficient basis for placing it in CNC status.

The National Taxpayer Advocate in March 2010 issued guidance to TAS employees discussing the *Vinatieri* decision and the IRM provisions that could lead to levies required to be immediately released.[16] In addition, TAS submitted draft language to the IRS recommending changes to the misleading IRM provisions, and is actively engaging the IRS in

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[15] Where unfiled returns (referenced in various IRM provisions) not only prevent the account from being placed into CNC status, but also lead the IRS to levy or propose to levy, the IRS will have abused its discretion under *Vinatieri*.

[16] TAS IGM, *Interim Guidance on Handling Collection Cases Where Economic Hardship Is Present but the Taxpayer Has Not Filed All Required Returns* (Mar. 23, 2010), *available at* http://www.irs.gov/pub/foia/ig/tas/tas-13_1-0110-01.pdf.

discussion.[17] As of October 1, 2010, the IRS has not implemented any of the suggested changes.[18] Thus, taxpayers continue to encounter the same situation as Mrs. Vinatieri and some of them have come to TAS for help.[19]

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[17] E-mail from Special Counsel to the National Taxpayer Advocate, Office of Chief Counsel, to Director, Collection Policy (Mar. 24, 2010); E-mail from TAS Collection Technical Liaison to Supervisory Revenue Officer, Small Business/Self Employed (SB/SE) Collection Policy (Sept. 16, 2010).

[18] According to Wage &Investment (W&I), "there is not a need to make additional changes to the IRM guidance or training material as it relates to addressing economic hardship situations." W&I response to TAS research request (July 9, 2010) (response to question 3). However, on Aug. 20, 2010, W&I issued a Servicewide Electronic Research Program (SERP) Alert 100440, *Vinatieri Decision: Guidance When a Taxpayer Who Has Been Levied Indicates That the Levy Is Creating a Hardship* (Aug. 20, 2010) reminding its employees of two circumstances in which accounts can be closed without securing an unfiled return, and that accounts can be referred for SFR processing or the delinquent return module can be sent to the queue. According to SB/SE, "Since the Vinatieri decision...analysts have been working on an IRM revision [sic] CNC procedures for the IRM 5.19.1. Any changes will be incorporated in the IRM rewrite." SB/SE response to TAS research request (July 13, 2010) (response to question 2).

[19] As of Sept. 9, 2010, TAS issued 62 Operations Assistance Requests (OARs) to the IRS operating divisions (ODs), advocating for taxpayers suffering from economic hardship when the IRS has issued a notice of levy or a Final Notice of Intent to Levy but will not place the account in CNC status or release a levy because of unfiled returns. While often the required returns are ultimately secured, TAS successfully advocated for placing the taxpayer's account in CNC status in five cases despite unfiled returns and

On January 19, 2010, shortly after the Tax Court issued the *Vinatieri* opinion, IRS Appeals Tax Policy & Procedures, working with the Office of Chief Counsel, reviewed and revised its IRM guidance. The revised IRM 8.22.2.4.2 will provide, in part, "if a taxpayer is entitled to CNC status based on economic hardship, he or she should be granted CNC status based on economic hardship, even if he or she has not filed all required returns."[20] Additionally, Appeals provided training to its settlement officers about the *Vinatieri* decision.[21] The National Taxpayer Advocate applauds the Appeals division for its willingness to revise procedures and provide guidance to employees to avoid repeating the error in *Vinatieri*. However, taxpayers will continue to face inappropriate levies unless the IRS compliance functions take a similar approach to *Vinatieri* servicewide.

The IRS Has Insufficient Internal Oversight and Review Procedures to Monitor for Economic Hardship.

An examination of IRS quality reviews illustrates the need for change. The Wage & Investment and

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successfully advocated for a levy release in 11 cases (one of these cases is included in the five CNC cases), despite unfiled returns.

[20] IRS Office of Appeals response to TAS research request (July 12, 2010) (response to question 3).

[21] *Id.*

Small Business/Self Employed divisions carry out quality reviews of randomly selected cases using the National Quality Review System (NQRS).[22] The reviewer evaluates, among other things, whether a collection employee considered a taxpayer's ability to pay and secured the taxpayer's financial information.[23] However, there is no specific rating for failing to properly manage the account of a taxpayer in economic hardship.[24] With respect to CNC determinations, the guidance references IRM 5.16.1, the same provision the settlement officer consulted in *Vinatieri*. Therefore, a quality reviewer today considering a case identical to *Vinatieri* would not be prompted to assign a negative rating based on the decision to proceed with a levy that would have to be immediately released. In addition to a revised IRM, taxpayers would benefit from an

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[22] W&I response to TAS research request (July 9, 2010) (response to question 4); SB/SE response to TAS research request (July 13, 2010) (response to question 3). National Quality Review System (NQRS) reviewers use appropriate Embedded Quality Job Aids in carrying out their reviews. IRM 5.13.1.6(2) (Sept. 9, 2007).

[23] *See* IRS Doc. 12359, *The Collection Field function Attribute Job Aid, available at* http://core.publish.no.irs.gov/docs/pdf/48360j09.pdf.

[24] W&I, in its response to TAS research request dated July 13, 2010 (response to question 4), indicated that it is proposing a new code that would measure "case disposition incorrect" or "case disposition not substantiated." An example of the latter would be a case where a taxpayer wants to make monthly payments, but IRS records do not substantiate that the taxpayer can pay, or they indicate that the account qualifies for CNC status.

NQRS standard that prompts the reviewer to actively consider whether the employee dealt appropriately with any economic hardship.

The Office of Appeals, which reviews cases through the AQMS,[25] considers whether the case file reflects a "quality decision," but does not specifically measure whether the taxpayer's possible economic hardship has been addressed.[26] An additional quality review standard, measuring whether a taxpayer's economic hardship, if any, was properly considered, would implement the spirit as well as the specific holding of *Vinatieri*.

CONCLUSION

To bring the IRS into compliance with the letter and the spirit of the *Vinatieri* decision regarding economic hardship, the National Taxpayer Advocate offers these preliminary recommendations:

1. The IRS should work with TAS to revise its IRM and other procedural guidance to clarify that all collection employees have authority to

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[25] *See* About the Appeals Quality Measurement System (AQMS), *available at* http://appeals.web.irs.gov/aqms/about_AQMS.htm.

[26] IRS Appeals response to TAS research request (July 12, 2010). The AQMS Reviewer's Guide in Collection Cases (Rev. Dec. 31, 2009), *available at* http://appeals.web.irs.gov/aqms/Documents/Collection_Reviewers_Guide.pdf, is 136 pages long and does not contain the word "hardship."

put a taxpayer's account into CNC status based on economic hardship even when the taxpayer has unfiled returns, independently of any other criteria.

2. The IRS should work with TAS to train collection employees how to manage taxpayer accounts when the taxpayer is facing economic hardship.

3. The IRS should establish quality review procedures that measure whether employees considered the possibility that a taxpayer was in economic hardship and managed accounts appropriately.

IRS COMMENTS

The IRS recognizes the importance of properly addressing economic hardship. Current guidance provides direction to collection employees on addressing situations and resolving cases when taxpayers experience economic hardship.[27] Written guidance also advises employees to use collection alternatives such as an installment agreement, an offer in compromise, and CNC to assist taxpayers who are experiencing financial hardship and are unable to pay their tax liability.

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[27] IRM 5.11.2.2.1.4 (Aug. 8, 2010); IRM 5.19.1.7.1 (Dec. 4, 2009); IRM 5.16.1.2.9 (June 29, 2010); IRM 5.19.4.4.10 (Mar. 8, 2010).

Since 2008, the IRS has expanded outreach efforts to ensure taxpayers understand the availability of payment alternatives and where to go for assistance in resolving their tax liability if they are experiencing hardship. A recent Treasury Inspector General for Tax Administration's (TIGTA) report stated,

> New provisions, along with modifications to and re-emphasis of existing procedures, provide many viable alternatives to help resolve taxpayers' balance due accounts. The provisions were widely communicated to the public and tax preparers through various public media outlets and presentations. In addition, the provisions and procedures were communicated to IRS employees through various channels and in updates to the Internal Revenue Manual.[28]

TIGTA also observed, "overall the IRS effectively implemented or re-emphasized options that will help economically distressed taxpayers who are now having difficulties paying their balance due accounts."

The IRS believes IRS collection policies and procedures maintain the proper balance between protecting the interest of the government and the rights of taxpayers. The fiscal year (FY) 2010

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[28] TIGTA, Ref. No. 2010-30-032, *Collection Alternatives Were Available to Economically Distressed Taxpayers, but Some New Processes Need Improvement* (Mar. 15, 2010).

collection program letter outlined collection priorities to improve customer service and monitor taxpayer compliance.[29] The 2011 program letter includes a specific priority to continue identifying and implementing procedures to assist taxpayers who are experiencing economic challenges.[30] The expanded outreach and the priorities of the collection program demonstrate the IRS' commitment to assist taxpayers experiencing hardship. In the report, the National Taxpayer Advocate cites the court decision *Vinatieri v. Commissioner*[31] in which the court held:

- IRC § 6343(a)(1)(D) and related regulations require release of a levy that creates an economic hardship regardless of the taxpayer's noncompliance with filing.

- A levy on the taxpayer's wages or car would cause the taxpayer to be unable to pay reasonable basic living expenses creating an economic hardship that would require release of the levy pursuant to IRC § 6343(a)(1)(D) and related regulations.

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[29] SB/SE, Collection Program Letter for FY 2010.

[30] SB/SE, Collection Program Letter for FY 2011.

[31] *Vinatieri v. Comm'r*, 133 T.C. No. 16 (Dec. 21, 2009), discussed *infra*.

- The IRS determination to proceed with a levy was wrong as a matter of law and therefore an abuse of discretion.

The IRS agrees that the decision to proceed with a levy in the *Vinatieri* case was not consistent with IRS policy or related laws and regulations. We recognized the need to clarify this guidance and subsequently worked with the Taxpayer Advocate Service to improve the economic hardship guidance contained in IRM 5.11.2 for release of levies. Specifically, guidance was added to address levy releases involving economic hardship (IRC § 6343(a)(1) (D)) on accounts where there are unfiled returns.[32] The revisions to the IRM were published August 8, 2010.

The IRS provided additional internal guidance changes to employees resulting from the *Vinatieri* decision.[33] These internal guidance changes will be

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[32] IRM 5.11.2.2.1.4(5) (Aug. 8, 2010) ("Where the financial analysis shows that the taxpayer merits a full or partial levy release to relieve economic hardship, the taxpayer has a statutory right to enough relief to end the hardship. Document the financial analysis in the history and communicate the decision to the taxpayer. The levy release should be faxed or given to the taxpayer to provide to the levy source. Caution: When the Service determines that the levy is creating an economic hardship, do not refuse, delay or understate the release amount as a means to secure other compliance, *e.g.*, missing tax returns.").

[33] IRM Procedural Updates (IPUs) are provided internally to collection employees via SERP. SERP is designed to provide

published in the next revisions of the IRM. Additional IRM revisions, including sections for which the IRS has received and reviewed input from TAS based on the *Vinatieri* decision, are currently in process.[34] As part of the routine clearance process for the IRM, the Office of the Taxpayer Advocate serves as a reviewer.

While the court correctly held in *Vinatieri* that a levy must be released due to economic hardship even when there are unfiled returns, it did not hold that the IRS should not pursue those returns. The IRS believes that it is entirely appropriate—as well as sound tax administration and good customer service—to fully address and resolve delinquent returns even though a levy cannot proceed or must be released. The IRS will continue to address and resolve unfiled tax returns in such cases, as the decision in *Vinatieri* did not question or undermine this policy.

Further, we do not believe that *Vinatieri* requires the immediate closure of a case as CNC upon a

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employees from all IRS functions with intranet access to IRMs and other reference materials, and to retrieve frequently referenced documents required to perform their jobs. The IRS issued IPUs for IRM 5.19.1.7.1(6) on August 17, 2010, IRM 5.19.1.7.1(8) on August 17, 2010, IRM 5.19.18.5(4) on September 1, 2010, IRM 5.19.1.3.4.1(6) on November 3, 2010, and for multiple related sections of IRM 5.19.1 on October 27, 2010.

[34] E-mail from TAS to Collection Policy regarding IRM 5.16.1.1(5) and (6) (Aug. 19, 2010).

determination that a levy is causing or would cause economic hardship. The issue presented and decided in Vinatieri was whether the proposed levy should proceed. Closing a case as CNC is not governed by *Vinatieri* and refers to an IRS administrative decision to remove an account from active inventory based on a determination that there is little or no current collection potential.[35] Although a CNC closure due to inability to pay is often referred to as a "hardship" case, such a determination may be made even when a levy is not a consideration.

As evidenced by the actions taken in response to *Vinatieri*, court decisions and changes in law are continually monitored by the IRS to determine potential impact. Based on the nature of the changes, the IRS updates policy and procedures to ensure employees are aware of any changes and take appropriate actions.

The IRS recognizes the importance of monitoring employee actions and maintaining adequate controls to ensure employees are taking appropriate actions when addressing economic hardship. Managerial safeguards and controls are incorporated into current IRS polices and procedures.

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[35] IRM 5.16.1.2.9 (June 29, 2010). Cases closed as CNC due to inability to pay that subsequently meet certain income thresholds may be reactivated to the collection inventory to determine if the taxpayer had a change in financial condition that would allow the taxpayer an ability to pay toward the outstanding tax liability.

IRS management uses an employee performance review and a national review system to assess and monitor the quality of case actions in collection cases.[36] In addition to whether a collection employee correctly analyzed a taxpayer's ability to pay and secured the taxpayer's financial information, the IRS reviews for appropriate case disposition, use of appropriate enforcement tools-including levy, customer impact, and observation of the taxpayer's rights.

There are opportunities available to ensure that taxpayers experiencing an economic hardship have recourse if they do not agree with a decision regarding an issuance of levy or a release of levy. Taxpayers have multiple appeal rights throughout the collection process; the most fundamental is an appeal to the manager.[37] The Collection Appeals Program (CAP), the Collection Due Process (CDP) hearing, and the opportunity for a taxpayer to request a judicial review of the Appeals determination by petitioning United States Tax Court all provide review and oversight opportunities to review collection actions.[38]

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[36] *See* IRS Doc. 12359, *The Collection Field function Attribute Job Aid, available at* http://core.publish.no.irs.gov/docs/pdf/48360j09.pdf.

[37] IRS Pub. 1, *Your Rights as a Taxpayer* (May 2005).

[38] IRS Pub. 1660, *Collection Appeal Rights* (Mar. 2007).

An in-depth managerial review process, a national review process, and the taxpayer's ability to request a review through the independent Office of Appeals collectively foster a robust and thorough internal oversight and review control to ensure that taxpayers who may be experiencing economic hardship are handled appropriately.

Additionally, external oversight ensures employees follow IRS policies and procedures authorized by IRC and Treasury regulations.[39] For example, TIGTA found, for the sixth year in a row, in its FY 2010 annual audit regarding IRS compliance with legal guidelines when issuing levies, "The IRS is protecting taxpayers' rights when issuing systemically generated and manually prepared levies."[40]

The National Taxpayer Advocate makes three preliminary recommendations to address IRS compliance with the *Vinatieri* decision regarding economic hardship. The IRS is taking or has taken the following actions with respect to these recommendations:

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[39] The Government Accountability Office (GAO) and TIGTA conduct independent reviews of IRS enforcement programs, including levy.

[40] TIGTA, Ref. No. 2010-30-068, *Fiscal Year 2010 Statutory Review of Compliance with Legal Guidelines When Issuing Levies* (June 15, 2010).

The IRS has proactively updated many of the internal procedures and is actively updating the remaining procedures based on the *Vinatieri* decision. IRM procedures currently advise employees that they must generally resolve unfiled returns prior to reporting an account CNC. IRM procedures also provide guidance for situations where an account may be reported CNC when an employee determines that the taxpayer is unable to pay the tax liability and has unfiled tax returns. In all situations, however, the unfiled returns must still be addressed. As part of the routine clearance process for the IRM, the Office of the Taxpayer Advocate serves as a reviewer.

The IRS agrees proper training and guidance for our employees is very important and, as such, continually looks for ways to improve. The IRS has drafted training materials to address economic hardship for collection field function employees for delivery in FY 2011 Continuing Professional Education. In FY 2010, the IRS delivered training on how to address economic hardship to Automated Collection System employees, Appeals settlement officers, and Appeals account resolution specialists.

Within the employee performance review, and the national review systems, there are many reviewed actions that are associated with ensuring taxpayer accounts are handled appropriately. These review systems look at many different facets of a case to ensure collection employees take the appropriate actions throughout the life of the case to arrive at a

correct and complete case resolution with no material adverse impact on the taxpayer.[41] The IRS utilizes contact recording and contact analytics to gather facts about specific complaints and conduct targeted reviews to identify areas needing improvement and training needs.

The National Taxpayer Advocate acknowledges that the SB/SE Collection Program Letter for FY 2011 states that the IRS will "continue to identify and implement procedures to assist taxpayers who are experiencing economic challenges."[42] However, because the IRS routinely issues final notices of intent to levy as part of an automated process, without contacting the taxpayer, the IRS is not necessarily aware that a taxpayer is in economic hardship when it proposes to levy.[43]

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[41] *See* IRS Doc. 12359, *The Collection Field function Attribute Job Aid*, *available at* http://core.publish.no.irs.gov/docs/pdf/48360j09.pdf.

[42] SB/SE Collection Program Letter for FY 2011, *available at* http://mysbse.web.irs.gov/AboutSBSE/ProgramLetters/17840.aspx.

[43] *See* Most Serious Problem: *IRS Policy Implementation Through Programming Systems Lacks Transparency and Precludes Adequate Review*, *supra*; Most Serious Problem: *The IRS's Failure to Provide Timely and Adequate Collection Due Process Hearings May Deprive Taxpayers of an Opportunity to Have Their Cases Fully Considered*, *supra*.

In the *Vinatieri* case, the IRS proposed to levy even though it *knew* of the taxpayer's hardship. While the IRS has revised a few offending sections of the IRM that would pertain to cases like *Vinatieri*, it has not corrected other sections. Thus, more than one year after the *Vinatieri* decision, taxpayers continue to be harmed because of the IRS's failure to correct its instructions to its employees.[44]

The errors in the *Vinatieri* case occurred because: (1) the IRM did not simply state that the IRS cannot levy or propose to levy on a taxpayer known to be in economic hardship (because if it does, it will be required by law to immediately release the levy); and (2) the IRM that permits CNC status for taxpayers in economic hardship was contradictory and incomplete in explaining the availability of

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[44] The IRS does not always submit its interim guidance that announces changes to the relevant portions of the IRM for TAS for review. Examples are SERP Alert 100539 dated Oct. 27, 2010, and SERP Alert 10040 dated Aug. 20, 2010. As of Dec.1, 2010, the only proposed revisions to the collection part of the IRM submitted to TAS for clearance using normal review procedures are IRM 5.9.16, received by TAS for review on Nov. 16, 2010; IRM 5.19.2, received on Nov. 26, 2010; and IRM 5.19.1, received on Nov. 30, 2010. TAS is working to clarify the IRM clearance process (for example, by participating on an Interim Guidance Task Force sponsored by the IRS's Servicewide Policy Directives and Electronic Research office) to ensure that proposed changes to the IRM are submitted to TAS for review when appropriate.

CNC status where there were unfiled returns. The IRS has not corrected either of these conditions.[45]

As the IRS observes, the Tax Court did not hold in *Vinatieri* that whenever the IRS becomes aware a taxpayer is in economic hardship, it must place his or her account into CNC status. As long as the IRS does not levy or propose to levy on a taxpayer it knows is in economic hardship, it operates consistently with the holding of *Vinatieri*.[46]

However, we wonder why the IRS would *not* put the account of a taxpayer experiencing economic hardship into CNC status when this status is the mechanism that prevents issuance of levies. Failure to put an eligible account into CNC hardship status creates an ongoing risk of a *Vinatieri*-type violation of law. Thus, we are baffled by the IRS's position in this regard.

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[45] The IRS in its response does not provide a reference to the training materials it used in 2010 on how to address economic hardship, and we are unable to identify any training materials that take into account or refer to the *Vinatieri* decision. TAS welcomes the opportunity to assist the IRS in developing 2011 training materials for collection employees.

[46] As the IRS also notes, nothing in the *Vinatieri* decision suggests that the IRS should not pursue unfiled returns. The National Taxpayer Advocate's position has never been that the IRS should not request unfiled returns.

The IRS has revised some of the CNC provisions in the IRM to conform to the *Vinatieri* decision.[47] For example, IRM 5.19.1.7.1.5, *CNC Unable to Pay - Hardship*, was revised on November 3, 2010, to instruct employees how to respond when a taxpayer contacts the IRS and claims that he or she is unable to pay, or that a levy on salary or wages is creating a hardship. The provision makes clear that the IRS must release the levy, and explains how to manage the taxpayer's accounts thereafter, including accounts with unfiled returns. However, according to the revised provision, tax years with unfiled returns will be closed and removed from active collection only in certain circumstances.[48] If those

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[47] *See, e.g.*, IRM 5.19.1.7.1(8); 5.19.18.5(4), discussed *supra*. As the IRS also notes, it has revised other provisions of the IRM pertaining to levy releases to clarify that a levy must be released if it is causing economic hardship, which is commendable, although we note that between Sept. 24, 2010, and Nov. 23, 2010, TAS successfully advocated for levy release due to economic hardship in five cases. In any event, however, the problems Mrs. Vinatieri encountered were not due to misapplication of IRM provisions that require the IRS to *release* a levy. Rather, the IRS, by *proposing* to levy when it knew the levy would cause hardship (and would therefore have to be immediately released), abused its discretion.

[48] One of the conditions is where the tax year for which there is an unfiled return "meets P-5-133 criteria," in which case the employee is to "close the [unfiled return year] little or no tax due, see IRM 5.19.2.6.4.5.3 [titled *IMF Little or No Tax Due*]." As explained *supra* note 9, Policy Statement P-5-133 enumerates factors that the IRS is to take into account in determining whether to enforce filing requirements. "Factors to be taken into account include, but are not limited to: prior history of

conditions are not present, or the IRS cannot determine whether they are present, it will not close those tax years, but rather will place them in the Queue.[49] Unlike tax years in CNC status, where collection activity is reactivated by changes in the taxpayer's financial condition, the IRS routinely transfers cases into and out of the Queue to balance inventory levels. Therefore, tax years assigned to the Queue may return to the collection stream as IRS inventories fluctuate, with the attendant risk that the IRS may once again propose or issue a levy without considering the previously determined hardship.[50] It is unclear why the IRS adopted the practice of placing tax years in the Queue because of unfiled returns when the taxpayer has already shown economic hardship and the IRS has released any levies because of the hardship. Adopting a policy of simply closing these tax years and placing

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noncompliance, existence of income from illegal sources, effect upon voluntary compliance, anticipated revenue, and collectibility, in relation to the time and effort required to determine tax due. Consideration will also be given any special circumstances existing in the case of a particular taxpayer, class of taxpayer, or industry, or which may be peculiar to the class of tax involved." IRM 5.19.1.7.1.5 as revised inappropriately reduces the application of Policy Statement P-5-133 to a single inquiry: the amount, if any, of tax due.

[49] The Queue is an electronic holding area for accounts that will not be worked immediately. *See* IRM 1.4.50.2.1.5 (July 1, 2007).

[50] *See* Most Serious Problem: *IRS Policy Implementation Through Systems Programming Lacks Transparency and Precludes Adequate Review, supra.*

them in CNC status would be easier to administer and would more effectively ensure that the errors in *Vinatieri* are not repeated.[51]

As the IRS notes, it may learn that a taxpayer is in economic hardship when a levy is not a consideration. If it does not place the account into CNC status at that point, the IRS may repeat the error of *Vinatieri* by later proposing or issuing a levy that it would immediately have to release. For example, a taxpayer requesting an offer in compromise based on effective tax administration may demonstrate that he or she is in economic hardship. The IRM does not make clear that from the moment the hardship is established, those accounts can be closed and placed into CNC status despite unfiled returns.[52] Instead, the IRM

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[51] Moreover, closing tax years with unfiled returns and placing the accounts into CNC status would "simplify or eliminate processes that unnecessarily burden taxpayer or IRS resources" and accomplish the seamless approach to service the IRS adopted in its FY 2009-2013 Strategic Plan. *See* IRS Pub.3744, *IRS Strategic Plan 2009-2013* (Apr. 2009), *available at* http://www.irs.gov/pub/irs-pdf/p3744.pdf.

[52] Part 5.8 of the IRM deals with offers in compromise. IRM 5.8.5.1, *Overview* (Sept. 23, 2008), references IRM 5.15, *Financial Analysis Handbook*, and directs that it be used in conjunction with the offer section. IRM 5.15.1.3, *Expectations* (Sept. 17, 2010), provides that the analysis of a taxpayer's financial condition is a basis on which to place an account into CNC status, but then cross-references IRM 5.16 rather than IRM 5.19. IRM 5.15.1.35, *Making the Collection Decision* (Oct. 2, 2009), contains the same provision.

references the same unrevised IRM provision the settlement officer relied on in *Vinatieri*.[53] The IRS should revise other portions of the IRM (not only those pertaining to levies) to permit classification of taxpayers' accounts as CNC when the IRS learns they are in economic hardship, independently of the context in which it acquires this information, and independently of any other consideration such as unfiled returns.

Moreover, some IRM provisions are still contradictory or inconsistent with the *Vinatieri* decision. For example:

- IRM 5.19.1.3.4.1(6) was revised and released through SERP on November 3, 2010, but continues to state: "When speaking to the taxpayer, address compliance on current year return filing as follows...Installment agreements and CNC hardships cannot be established if a return is required to be filed... you can not allow the installment agreement or CNC hardship without securing all required returns."

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[53] As another example, a taxpayer requesting innocent spouse relief may demonstrate economic hardship. IRM 25.15.2.1, *Employees with Taxpayer Contact* (July 17, 2009), found in the Relief from Joint and Several Liability portion of the IRM, simply directs the employee to refer the taxpayer to TAS ("If during a taxpayer contact it appears a hardship situation may exist, complete Form 911, Request for Taxpayer Advocate Service Assistance (And Application for Taxpayer Assistance Order), and refer the taxpayer to the Taxpayer Advocate Service (TAS).")

- IRM 5.19.18.5.7 was revised and released through SERP on September 1, 2010, but now provides: "Cases are manually assigned to this inventory prior to initiating a currently-not-collectible (CNC) when...**All** levy sources have been exhausted."

- IRM 5.19.18.5.8(5) was revised and released through SERP on September 1, 2010, but now directs: "CAUTION: **Do not** report any cases as CNC (hardship) until all delinquent returns are filed and the cause of the delinquency addressed."

- Various IRM provisions, particularly those that collection field employees rely on, still instruct employees to "resolve" or "close" tax years with an unfiled return before placing an account into CNC status (IRM 5.16.1.1; IRM 5.16.1.1(6); IRM 5.16.1.2.9(8); IRM 5.19.1.7.1(6) (which cross-references 5.19.1.3.4.1, above)), without specifying that where there is economic hardship, "resolving" or "closing" does not necessarily mean securing unfiled returns. As long as these provisions are intact, and are relied upon by compliance employees and sustained by quality reviewers, the IRS may repeat the same errors it made in the *Vinatieri* case.

Recommendations

In summary, the National Taxpayer Advocate recommends that the IRS:

1. Continue to work with TAS to revise its IRM and other procedural guidance to clarify that all collection employees are authorized to close tax years with unfiled returns, and place a taxpayer's account into CNC status based on economic hardship, without securing unfiled returns, independently of any other criterion or condition.

2. Work with TAS to train collection employees how to manage accounts when the taxpayer is facing economic hardship and submit its 2011 collection CPE training materials on this issue to TAS for review.

3. Establish quality review procedures that measure whether employees considered the possibility that a taxpayer was in economic hardship and managed the account appropriately.

LR #8

Revise the Willfulness Component of the Trust Fund Recovery Penalty Statute to Encourage Business Owners to Continue Operation of Financially Struggling Businesses When the Tax Liability Accrues Due to an Intervening Bad Act

PROBLEM

Employers are generally required to withhold employment taxes, income tax, and certain types of excise taxes, often referred to as the "trust fund" taxes, from payments to employees.[1] Internal Revenue Code (IRC) § 6672 provides for the assessment of a Trust Fund Recovery Penalty (TFRP) against those deemed responsible persons when these monies are not paid as required.[2] To

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[1] *See generally* IRC §§ 3101, 3102, 3111-3113, and 3121-3128 (Federal Insurance Contributions Act); IRC §§ 3201, 3202, 3211, 3221, 3231-3233 and 3241 (Railroad Retirement Tax Act); IRC §§ 3301-3311 (Federal Unemployment Tax Act); IRC §§ 3401-3407 (collection of income at source on wages). For excise taxes, *see, e.g.*, IRC §§ 4251; 4261; 4271. IRC § 7501 provides that taxes withheld from others, which are to be paid to the United States, are held in a special fund in trust for the United States. These taxes are often referred to as the "trust fund" taxes.

[2] "Responsible person" is generally defined as an officer or employee of the organization, who has sufficient control and authority to collect, truthfully account for, and pay over the withheld taxes, but willfully fails to do so. IRC §§ 6671(b) and 6672(a). *See also Cline v. U.S.*, 997 F.2d 191 (6th Cir. 1993); *McGlothin v. U.S.*, 720 F.2d 6 (6th Cir. 1983).

establish liability under IRC § 6672, the IRS must conclude a person was responsible for withholding and paying over to the IRS payroll taxes and that the failure to do so was willful.[3] The willfulness component of the statute is satisfied if the person had knowledge of the employer's obligation to pay withholding taxes and knew the funds were being used for other purposes.[4] The statute does not contain a reasonable cause exception.[5]

The United States Supreme Court has limited the application of the penalty in cases where a financially troubled company changed ownership and an individual became a responsible person after

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[3] IRC § 6672 applies to taxes collected and paid over by a third party. It does not apply to taxes directly imposed on the person or entity required to pay them, *e.g.*, it does not apply to the employer's share of FICA or FUTA. IRC §§ 3101 and 3301.

[4] *See Hochstein v. U.S.*, 900 F.2d 543, 548 (2d Cir. 1990), *cert. denied*, 504 U.S. 985 (1992). A person has acted with willfulness if his or her actions were voluntary, conscious, and intentional as opposed to being merely negligent.

[5] There is a split in circuits on this issue. While most circuits reject the contention that reasonable cause or justifiable excuse plays a part in determining whether the responsible party's actions are willful, the U.S. Court of Appeals for the Fifth Circuit held that, in very limited circumstances, reasonable cause could have an effect on a willfulness determination. *See Harrington v. U.S.*, 504 F.2d 1306 (1st Cir. 1974); *Monday v. U.S.*, 421 F.2d 1210 (7th Cir. 1970); *Olsen v. U.S.*, 952 F.2d 236 (8th Cir. 1991); *Bloom v. U.S.*, 272 F.2d 215 (9th Cir. 1959). *Cf. Newsome v. U.S.*, 431 F.2d 742 (5th Cir. 1970); *McCarty v. U.S.*, 194 Ct. Cl. 42 (1971).

the liability accrued,[6] to provide the company with "minimum working capital .... to maintain operations and avoid liquidation of the business."[7] However, courts have adopted a rather "harsh" interpretation of the willfulness component of the statute in situations where there was no change in ownership.[8] To avoid TFRP liability, a responsible person must use all available funds to pay off back trust fund taxes and cannot use any portion of after-acquired funds as a working capital to pay current operating expenses, even if it may result in liquidation of the business.[9] This outcome does not change if the delinquency was caused by a third party bad act, such as mismanagement or embezzlement, by an employee or by a third party

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[6] *Slodow v. U.S.*, 436 U.S. 238 (1978) (holding that the individual's conduct was not willful when he used after-acquired funds for operating expenses of the business).

[7] *In re Rossiter*, 167 B.R. 919 (C.D. Cal. 1994) (applying *Slodow* analysis).

[8] *See, e.g., Buffalow v. U.S.*, 109 F.3d 570, 573 (9th Cir. 1997); *Phillips v. U.S.*, 73 F.3d 939, 943 (9th Cir. 1996). *See also* Corrie Lynn Lyle, *The Wrath of IRC § 6672: The Renewed Call for Change – Is Anyone Listening? If You Are a Corporate Official, You Had Better Be*, 74 S. Cal. L. Rev. 1133 (May 2001).

[9] Willfulness exists if the responsible person obtains knowledge of a withholding tax delinquency and continues to permit payments to be made to other creditors. *Monday v. U.S.*, 421 F.2d 1210 (7th Cir. 1970), *cert. denied*, 400 U.S. 821 (1970); *Gephart v. U.S.*, 818 F.2d 469 (6th Cir. 1987); *Stettler v. U.S.*, 98-1 U.S.T.C. ¶ 50,136 (10th Cir. 1998); *Wright v. U.S.*, 809 F.2d 425 (7th Cir. 1987).

payer.[10] Because the assessment of the TFRP can have disastrous economic consequences on those deemed responsible, this rule provides a disincentive for keeping financially struggling businesses afloat by paying businesses' operating expenses and current employment tax liabilities, while repaying past delinquencies in installments.

EXAMPLE

A small construction business incurred a payroll tax liability of about $500,000 as a result of embezzlement by a trusted company controller. As soon as the company's management became aware of the delinquency, it contacted the IRS and arranged to pay past taxes in installments while being current with payment and filing obligations. To keep the business a going concern and generate income to repay the past delinquencies, the management continued to pay current operational expenses, including rent, accounts receivable, suppliers, etc. Although the controller admitted his guilt and was subsequently convicted, the amount of restitution did not cover the accrued delinquencies, nor did the company's business

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[10] *See, e.g., Anuforo v. Comm'r*, 614 F.3d 799 (8th Cir. 2010); *McCloskey v. U.S.*, 104 A.F.T.R.2d (RIA) 6378 (W.D. Pa 2009). *See also Howard v. U.S.*, 711 F.2d 729 (5th Cir. 1983); *Mazo v. U.S.*, 591 F.2d 1151 (5th Cir 1979); *Garsky v U.S.*, 600 F.2d 86 (7th Cir. 1979). *See also* National Taxpayer Advocate 2007 Annual Report to Congress 337, 538 (Most Serious Problem: *Third Party Payers;* Legislative Recommendation: *Taxpayer Protection from Third Party Payer Failures*).

insurance cover the amount embezzled. The IRS assessed TFRPs against corporate officers and filed notices of federal tax lien against their personal assets.[11] As a result, the company lost its line of credit, which was dependent on the creditworthiness of its officers and shareholders. The company went out of business, leaving 15 people, including the officers, unemployed. Although the officers liquidated the remaining assets, the proceeds were insufficient to pay off the liability, and the IRS acted to enforce federal tax liens against the officers' homes.

RECOMMENDATION

The National Taxpayer Advocate recommends that Congress amend IRC § 6672 to provide that the conduct of a responsible person who obtains knowledge of trust fund taxes not being timely paid because of an intervening bad act shall not be deemed willful if the delinquent business: (1) promptly makes payment arrangements to satisfy the liability based upon the IRS's determination of the minimal working capital needs of the business, and (2) remains current with payment and filing obligations.

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[11] The IRS's policy is not to pursue the TFRP so long as there is an installment agreement (IA) in place with the business, unless there are statute of limitations issues or a default on IA is entered. IRS Policy statement 5-14, IRM 1.2.14.1.3(8) (June 9, 2003).

PRESENT LAW

IRC § 6672 imposes a penalty on any person required to collect, truthfully account for, and pay over any tax imposed under the Code where that person willfully fails to do so, or willfully attempts to evade tax. This is referred to as a trust fund recovery penalty, which is also called the 100 percent penalty because the amount is equal to 100 percent of the trust fund taxes evaded, not collected, or not accounted for and paid over.[12] Trust fund taxes include employment taxes, income tax withheld from employees' wages, and certain types of excise taxes.[13] To establish liability under IRC § 6672, the IRS must conclude a person was responsible for withholding and paying over to the IRS payroll taxes and that the failure to do so was willful.[14] The determination of whether a person

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[12] IRC § 7501 provides that taxes withheld from others, which are to be paid to the United States, are held in a special fund in trust for the United States. The IRS is required to credit the employees for the withheld taxes even if the employer fails to remit them. IRC § 31(a). *See also Slodov v. U.S.*, 436 U.S. 238 (1978).

[13] *See generally* IRC §§ 3101, 3102, 3111-3113, and 3121-3128 (Federal Insurance Contributions Act); IRC §§ 3201, 3202, 3211, 3221, 3231-3233 and 3241 (Railroad Retirement Tax Act); IRC §§ 3301-3311 (Federal Unemployment Tax Act); IRC §§ 3401-3407 (collection of income at source on wages). For excise taxes, *see, e.g.*, IRC §§ 4251, 4261, 4271.

[14] "Responsible person" is generally defined as an officer or employee of the organization, who has sufficient control and authority to collect, truthfully account for, and pay over the

was responsible for withholding and paying payroll taxes depends on the individual's status, duty, and authority in the context of the business.[15]

The willfulness component of the statute is satisfied if the person had knowledge of the employer's obligation to pay withholding taxes and knew the funds were being used for other purposes.[16] Willfulness does not require specific criminal intent or evil motive.[17] The courts apply these general standards to determine whether a responsible person acted willfully:

- **Deliberate choice** – Willfulness exists where the responsible person makes the deliberate choice to pay withholding taxes to other

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withheld taxes, but willfully fails to do so. IRC §§ 6671(b) and 6672(a). *See also Cline v. U.S.*, 997 F.2d 191 (6th Cir. 1993); *McGlothin v. U.S.*, 720 F.2d 6 (6th Cir. 1983).

[15] *Thiboudeau v. U.S.*, 828 F.2d 1499 (11th Cir. 1987), *cert. denied*, 506 U.S. 1050 (1993); *George v. U.S.*, 819 F.2d 1008 (11th Cir. 1987).

[16] *See Hochstein v. U.S.*, 900 F.2d 543, 548 (2d Cir. 1990), *cert. denied*, 504 U.S. 985 (1992). A person has acted with willfulness if his or her actions were voluntary, conscious, and intentional as opposed to being merely negligent. *See also Kalb v. U.S.*, 505 F.2d 506, 511 (2d Cir. 1974).

[17] *See, e.g., Thomas v. U.S.*, 41 F.3d 1109 (7th Cir. 1994).

creditors, instead of paying the taxes over to the IRS;[18]

- **Knowledge of nonpayment of taxes** – Willfulness exists if the responsible person obtains knowledge of a withholding tax delinquency and continues to permit payments to be made to other creditors;[19] and

- **Reckless disregard** – Willfulness exists where the responsible person acts with a reckless disregard of a known or obvious risk that withholding taxes will not be remitted, including failing to investigate or correct mismanagement after being notified that withholding taxes have not been paid.[20]

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[18] *See Howard v. U.S.*, 711 F.2d 729 (5th Cir. 1983); *Mazo v. U.S.*, 591 F.3d 1151 (5th Cir. 1979).

[19] *See, e.g., Gephart v. U.S.*, 818 F.2d 469 (6th Cir. 1987); *Stettler v. U.S.*, 98-1 U.S.T.C. ¶ 50,136 (10th Cir. 1998); *Monday v. U.S.*, 421 F.2d 1210 (7th Cir. 1970), *cert. denied* 400 U.S. 821 (1970); *Thosteson v U.S.*, 331 F.3d 1294 (11th Cir. 2003), *cert. denied*, 540 U.S. 1105 (2004).

[20] *See, e.g., George v. U.S.*, 819 F.2d 1008 (11th Cir. 1987); *Denbo v. U.S.*, 988 F.2d 1029 (10th Cir. 1993); *Honey v. U.S.*, 963 F.2d 1083 (8th Cir. 1992), *cert. denied*, 506 U.S. 1028 (1992); *Godfrey v. U.S.*, 748 F.2d 1568 (Fed. Cir. 1984); *Mazo v. U.S.*, 591 F.2d 1151 (5th Cir. 1979).

The statute does not contain a reasonable cause exception.[21] In *Slodov v. U.S.*, the Supreme Court addressed liability of a successor, and limited the application of the penalty in cases where a financially troubled company changes ownership and an individual becomes a responsible person after the delinquency and change of ownership occurred.[22] The court held that the individual's conduct was not willful when he used after-acquired funds for operating expenses of the business after the liability accrued.[23] The reasoning of *Slodov* also applies to individuals who become responsible persons after the taxes accrue, even if no ownership change has occurred.[24] However, to avoid personal liability for past delinquencies, a person deemed responsible must use all unencumbered funds to pay the back taxes after he or she obtains

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[21] There is a split in circuits on this issue. While most circuits reject the contention that reasonable cause or justifiable excuse plays a part in determining whether the responsible party's actions are willful, the U.S. Court of Appeals for the Fifth Circuit held that, in very limited circumstances, reasonable cause could have an effect on a willfulness determination. *See Harrington v. U.S.*, 504 F.2d 1306 (1st Cir. 1974); *Monday v. U.S.*, 421 F.2d 1210 (7th Cir. 1970); *Olsen v. U.S.*, 952 F.2d 236 (8th Cir. 1991); *Bloom v. U.S.*, 272 F.2d 215 (9th Cir. 1959). *Cf. Newsome v. U.S.*, 431 F.2d 742 (5th Cir. 1970); *McCarty v. U.S.*, 194 Ct. Cl. 42 (1971).

[22] *Slodov v. U.S.*, 436 U.S. 238 (1978).

[23] *Id.*

[24] *Mazo v. U.S.*, 591 F.2d 1151 (5th Cir 1979).

knowledge of a trust fund tax delinquency.[25] This duty extends not only to funds available at the time the responsible person becomes aware of the delinquency, but also to any funds acquired thereafter regardless of why the delinquency occurred.[26]

REASONS FOR CHANGE

As a result of the courts' interpretation of the willfulness component of the statute, in situations where no changes in ownership occurs, the responsible person must use all available funds to pay the delinquency and cannot use any of the funds to pay operating expenses of the business to avoid personal liability for TFRP. This outcome does not change if the delinquency resulted from a third

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[25] *Monday v. U.S.*, 421 F.2d 1210 (7th Cir. 1970), *cert. denied*, 400 U.S. 821 (1970) (the responsible party knew those taxes were due but nevertheless wrote checks to other creditors and suppliers); *Wright v. U.S.*, 809 F.2d 425 (7th Cir. 1987); *Howard v. U.S.*, 711 F.2d 729 (5th Cir. 1983); *Mazo v. U.S.*, 591 F.2d 1151 (5th Cir. 1979). Encumbered funds are money that the taxpayer is legally obligated to use for a purpose other than satisfying the preexisting tax liability. The claim of the other creditor must be superior to the IRS. *Honey v. U.S.*, 963 F.2d 1083 (8th Cir. 1992), *cert. denied*, 506 U.S. 1028 (1992); *U.S. v. Kim*, 111 F.3d 1351 (7th Cir. 1997).

[26] *Garsky v. U.S.*, 600 F.2d 86 (7th Cir. 1979); *U.S. v. Kim*, 111 F.3d 1351 (7th Cir. 1997). Even if money intended for payment of taxes was embezzled, the responsible party remains liable for the penalty. *Anuforo v. Comm'r*, 106 A.F.T.R.2d (RIA) 5596 (8th Cir. 2010). *See also Purcell v. U.S.*, 1 F.3d 932 (9th Cir. 1993); *Buffalow v. U.S.*, 109 F.3d 570, 573 (9th Cir. 1997).

party bad act, such as mismanagement, embezzlement by a trusted employee, or by a third party payer.[27] The taxpayer's willfulness is generally established if he or she pays other creditors instead of paying the IRS after finding out about the embezzlement, even if those payments are made in an effort to keep the business going. Thus, during a period of financial hardship, a responsible person must always continue to repay back taxes even when funds to operate the business are not available.[28]

Courts and legal scholars have commented that the current judicial interpretation of willfulness is "harsh," "draconian," and "somewhat counterintuitive," and advocated for change in the statute.[29] This interpretation appears to cause unjust results when a responsible person of a struggling business tries to resolve past tax

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[27] *Anuforo v. Comm'r*, 106 A.F.T.R.2d (RIA) 5596 (8th Cir. 2010); *McCloskey v. U.S.*, 104 A.F.T.R.2d (RIA) 6378 (W.D. Pa 2009). *See also* National Taxpayer Advocate 2007 Annual Report to Congress 337, 538 (Most Serious Problem: *Third Party Payers*; Legislative Recommendation: *Taxpayer Protection from Third Party Payer Failures*).

[28] *See, e.g., Sorenson v. U.S.*, 521 F.2d 325, 327 (9th Cir. 1975).

[29] *Buffalow v. U.S.*, 109 F.3d 570, 573 (9th Cir. 1997); *Phillips v. U.S.*, 73 F.3d 939, 943 (9th Cir. 1996). *See also* Corrie Lynn Lyle, *The Wrath of IRC § 6672: The Renewed Call for Change – Is Anyone Listening? If You Are a Corporate Official, You Had Better Be*, 74 S. Cal. L. Rev. 1133 (May 2001).

delinquency, which resulted from an intervening bad act, and agrees to repay the liability in installments instead of liquidating the business.[30]

In the context of a buyout of a struggling company, the Supreme Court in *Slodov* commented that although the IRS "encourage[s] the responsible person to continue operation with the hope of receiving the payment of back taxes, if the attempt fails and the taxes remain unpaid, the IRS insists that the § 6672 personal liability penalty attached upon payment of the first dollar to a supplier."[31] The court also stated that a responsible person has no obligation to liquidate business assets and refused to construe IRC § 6672 to discourage changes of ownership and management of financially troubled companies.[32] In the same context, another court

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[30] For example, in *Baimbridge v. United States* the potentially responsible person attempted to address the willfulness component of the TFRP liability test by arguing that the corporation had entered into an installment agreement for the repayment of the delinquent tax, and therefore, the IRS should be estopped from assessing the penalties because it was fully aware that the business was going to continue operation and satisfy non-IRS creditors. *Baimbridge v. U.S.*, 335 F. Supp. 2d 1084 (S.D. Cal. 2004). The court noted "that serious injustice may result from a penalty assessment being predicated on non-IRS payments which were contemplated by the installment agreement" and denied the IRS's motion for summary judgment on the issue of willfulness, thereby requiring the parties to go to trial.

[31] 436 U.S. at 252.

[32] *Slodov v. U.S.*, 436 U.S. 238 (1978).

noted that the financially struggling business should be allowed "minimum working capital .... to maintain operations and avoid liquidation of the business."[33]

This reasoning is equally applicable to a financially struggling business that became a victim of a third party bad act. It is in the best interests of the government to encourage business owners to continue in business and pay off the delinquencies in installments rather than liquidate and lay off employees. Because current judicial interpretation of the TFRP willfulness component effectively requires a business owner to stop operating a business and pay all available cash to the IRS, the government may be forced to make outlays in the form of unemployment benefits, food stamps, and the like to the business owner and the laid-off employees. Thus, the strict application of the TFRP willfulness component has the potential to destroy the taxpayer's business, financially damage the taxpayer's family, and simultaneously reduce future federal revenue.

EXPLANATION OF RECOMMENDATION

Because courts strictly interpret the willfulness prong of the TFRP, persons deemed responsible are required to use all available funds to pay a tax delinquency after they obtain knowledge of the delinquency, regardless of the reasons why the

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[33] *In re Rossiter*, 167 B.R. 919 (C.D. Cal. 1994).

delinquency occurred. The National Taxpayer Advocate recommends amending IRC § 6672 to provide that the conduct of a responsible person who obtains knowledge of trust fund taxes not being timely paid because of an intervening bad act shall not be deemed willful, if the delinquent business: (1) makes payment arrangements to satisfy the liability based upon IRS's determination of minimal working capital needs of the business, and (2) remains current with payment and filing obligations.[34]

This legislative change will provide for uniform treatment of similarly situated taxpayers in the context of a financially struggling business, both when change of ownership occurs and when the liability accrues due to an intervening bad act. It will also encourage a responsible person to continue operation of the business and enter into payment arrangements with the IRS on behalf of the business, rather then resign after obtaining knowledge about the liability. This legislative change would not relieve from liability responsible persons who caused the delinquency to accrue.

In addition, the National Taxpayer Advocate recommends that the IRS be given authority to determine minimal working capital needs of a financially struggling business. Similar to the IRC § 7122(d)(2) requirement for allowable living

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[34] Multiple persons may be responsible for TFRP. Therefore, responsible persons who did not apply for a relief under this provision will remain liable for TFRP under current law.

expenses analysis, the IRS should base its determination of minimal working capital needs on a thorough analysis of all facts and circumstances of each taxpayer and ensure that its determination will not leave the taxpayer without adequate funds to meet its basic operating expenses, including current and future tax obligations.[35]

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[35] In 1995, the IRS developed and implemented the allowable living expenses (ALE) approach to determining an individual taxpayer's financial ability to pay delinquent taxes, which serve as the basis for various collection alternatives, such as installment agreements, CNC determinations, and offers-in-compromise. The IRS Restructuring and Reform Act of 1998 also requires the IRS to prescribe guidelines to determine whether to accept an offer in compromise, which in essence codified the IRS's use of the ALE. Pub. L. No. 105-206, § 3462(a) (1998) (codified at IRC § 7122(d)(2)). The ALE standards are not applicable to corporations, partnerships, LLCs, where the LLC is identified as the liable taxpayer, or any Business MasterFile expenses. IRM 5.15.1.7 (Oct. 2, 2009).